

103
**STAFFING NEEDS IN SELECTED
HUD DIVISIONS**

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Staffing Needs in Selected HUD Divi...

HEARING
BEFORE THE
SUBCOMMITTEE ON
HOUSING AND COMMUNITY DEVELOPMENT
OF THE
COMMITTEE ON BANKING, FINANCE AND
URBAN AFFAIRS
HOUSE OF REPRESENTATIVES
ONE HUNDRED THIRD CONGRESS
FIRST SESSION

OCTOBER 29, 1993

Printed for the use of the Committee on Banking, Finance and Urban Affairs

Serial No. 103-89



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STAFFING NEEDS IN SELECTED HUD DIVISIONS

FRIDAY, OCTOBER 29, 1993

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING
AND COMMUNITY DEVELOPMENT,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Henry B. Gonzalez [chairman of the subcommittee] presiding.

Present: Chairman Gonzalez and Representative Watt.

Chairman GONZALEZ. The subcommittee will please come to order.

Let me at the outset thank the participants, the witnesses, that responded very quickly and, in fact, on short notice. And I want to urge you not to be disappointed or in any way discouraged if a few members amble in after a while, or don't. What is happening is that the system has become quite unpredictable as far as House legislative scheduling.

Originally, we had been informed that it would be the intention of the leadership to have business, legislative business, today and votes. So when we announced the hearing, we polled the members and we had substantial response. I am sure that that was based on the fact that they too thought the House would be in session.

In this day and time, given the aspects of public office, and especially the 2-year terms, after 32 years in office, I have observed the tremendous erosion of the institutional integrity of the processes of the legislative branch, and one of the contributing factors is reflected in this.

In fact, as I have witnessed other things happening being a member of this full committee and the subcommittee, I have sadly watched the situation we have come to be in. It was quite obvious that it was coming along and nobody seemed to much care.

This is a special world. It is even in the State legislative world, as some of you who may have some experience know. Ironically, the contributing factor to this date at this point is the 1974 legislative reforms and the Budget Reform Act of 1974. In the name of reform, we really have quite a bit of disorder.

So I want to emphasize, though, that there is a tremendous struggle at the outset of the organizational period in the beginning of a Congress, such as this first session. There is a tremendous struggle in the Banking Committee for members to join this subcommittee now.

I remember when it was very different. But since the advent of the 1970's and the Block Grant Programs and grants and all, this has become quite an attractive subcommittee. But I am never ceased to be amazed that there will be a tremendous struggle. In fact, it became so large just two, three, four Congresses ago, that we had to go to the caucus to ask for a rules change to limit the size of the subcommittee to be no more than 70 percent of the full committee.

I became chairman of this subcommittee in 1981, and every inch of the way I have been contested for the chairmanship. In 1985, the full committee had only four more members than the subcommittee. When we would have what we call a markup, the amendatory process of legislation, we would have to wait a considerable amount of time before we could get the necessary quorum to begin.

The reason being, the 1974 Reform Act, in which for the first time the principle evolved whereby political activity at this level could be accompanied by those ambitious to seek some power. Before that, the rule and the rule of thumb since the first Congress, and the unique American characteristic, was seniority. Even today, after the reform, there is still not a substitute for that.

However, following the 1974 act, and the first Congress in 1975, it became effective. The chairman of this subcommittee was dumped, and we had a tremendous period of upheaval until right up to 1989.

The same thing happened with two other basic committees. With one in particular, the defense, or the Armed Services Committee, an eighth ranking member was able to maneuver enough votes to dump the chairman. He jumped over seven or eight others, and that created a terrible disparity to this day. We still do not have the appropriation of defense, but the authorization took not one rule but four rules. Four different rules for just the authorization.

If a historian ever records all of that, which even the political scientists who have written on the Congress have not made particular note of, it will revert to the so-called reform of 1974. Today, there is a big clamor to reform the workings again.

So I think it is reflective also of what has seeped into our processes where you have \$1, \$2, \$3, \$4, \$5 million campaigns for this office. Today, it seems to me, and I have made this observation before, that it is so difficult and so costly to seek public office, whether it is at the Federal or local level. In fact, back home, the prior mayor, in his last two elections, in which actually there was very little contest, the expenditures he reported averaged \$650,000. He was seeking local office only.

So you can see for yourself that not we, but the American people, have a very serious problem. It seems to me that when an individual, man or woman, goes through a competitive process, and finds themselves victorious, he or she concludes psychologically, well, I did it, I won, I have done the job, whereas he or she merely has the license to do the job. Unfortunately, the latter psychology prevails.

So no sooner do we start a session, like we did in January, where every day you have a fund raiser somewhere either to pay off the expenses of the last election or to shore up a kitty for next year's election. For the life of me, I cannot see why I would want to over-extend myself, as I did not when I had the chance to belong to as

many as 12 subcommittees. At that time I could have a major committee assignment and a minor committee assignment, and each one of those committees had any number of subcommittees. I knew that there was no way I could satisfactorily do the work, so I had picked those of interest.

I had the benefit of the experience of serving 5 years in the State Senate and then, before that, 3 years on the local legislative body known as the city council. Those were tremendous privileges that have provided me perspective in explaining to you why probably the largest subcommittee, even now limited by the rules to no more than 60 percent of the full Banking Committee, still cannot produce, on an important occasion like this one. This is very important.

I am not apologizing because I know that each member has a reason. I would say that 100 percent are back home, and that is fine. But I am a Depression era kid. I know what it is to work for 10 cents an hour, and I think the salary we get calls for a 5-day workweek, and that means Monday through Friday. I have scheduled Friday hearings before and found myself pretty much alone, even in the full committee.

In fact, this month, 3 years ago, 1990, I called a hearing, two hearings, one of which was on the BCCI. The other was on the impact on the financial institutions and the economy by what broke out the following January in 1991, the Persian Gulf war, and we had no members in attendance. The Chairman of the Federal Reserve Board came and he stated, for the record—yet no newspaper so much as reported, no coverage—that 70 percent of the cause of what he was not willing to define as a recession, was the impact of the diversion of resources to this buildup. It was thoroughly overlooked.

The reason we called the hearing was because the Secretary of State said that the main reason for the involvement was jobs. We noticed the fluctuations in some of the markets, Treasury bills, Open Market Committee results of 6 months before, and we called a hearing. It is on the record, for whatever good it does.

I go back to 1983, when the level of foreclosures of single-family dwellings in some areas were up, like today, where recession is spotted; more in one area than another—people are hurting. If any member really bothers to get back and talk to a good cross-section, there might be a little more sensitivity up here.

People are hurting and they are fearful and they are unemployed. And when I say they are unemployed, I am not talking about the usual lamentations about the undue proportion in some sectors of our society. I am talking about 35-, 36-, 37-year-olds; I am not talking about the unskilled because many of those unemployed back home, and I have a list, are college prepared.

When these individuals report that for more than 1 year, in fact, 1½ years, they have been unable to find employment, I would say that that is different from what I have seen reflected in my office for the 40 years I have been in public elective office. That is a good barometer.

But when we noticed that, for instance, in the Pittsburgh area, the incidence or percentage or level of foreclosures, not temporary failures to pay a mortgage, but foreclosures, had reached a higher

level than the median average during the Depression, we thought we had a responsibility. This was about the end of 1982, when we were also having the first hearings on what has turned out to be homelessness. The first hearing was here December 15, 1982.

So you might say, well, what is this all leading up to here this morning? Well, it has everything to do with it. The basic structure—the framework of reference that forms the basis even today of what we call the assisted housing programs, plus what we do not call but are just as much assisted as anything else, the traditional built-in programs—has enabled America to perform a miracle in housing its citizens after the war. All of the basic framework was structured in the foundation of the housing programs created in the 1930's during the Depression period. The population of the country was roughly a third of today. This is reflected in the financial mechanisms that formed the correlative components of the program where the Nation made a commitment to house its citizens. It was a national commitment.

After the war, there were tremendous societal and demographic changes, and technological breakthroughs which impacted not only the country but the whole world. Also the system of reference in such things as construction at affordable rates, the distribution or purchase of shelter, at affordable cost, and, more importantly, the swing from home ownership to rental, have changed since the nature of the tenure of housing has changed, particularly in the urban areas. There is no basic national law regulating or even taking those issues into consideration. The main thing is it has been sort of an accumulation of different ad hoc approaches, including the so-called block grant approaches of the 1970's.

However, what has resulted is, just as in the case of banking and financial institutions, about the worst possible world. If you say that you fundamentally believe in private enterprise and nonsocialistic programs, if that is the way you want to define it, then we have it. This is illustrated by what we did when we hit the crisis in the savings and loan industry, which, of course, was an integral part of the housing commitment of the 1930's, was to then nationalize some.

The same thing happened with banking, though it is less apparent because there are many more banks than there are S&Ls. Banks have been able to fluff over the dimensions of the continuing critical problem.

For instance, for a few years, advocates of FHA have said it has outlived its fundamental premise, purpose and serviceability. FHA did perform magnificently. It did, through tax expenditures, provide a subsidy way deeper than any cumulative public subsidy to the other so-called assisted housing programs.

When we reach the point we have—even though we are still trying to get these pieces together and see what is workable—we find that you have a situation where, apparently, the real estate markets are desperately attempting to sustain some level of market share. You could say they want to stabilize their market share yet you still have flux.

However, with HUD, the government's portfolio, or inventory of dwellings—setting aside the multihousing and strictly talking about the single family—we now have reached a point where you

may, if you want, concentrate on the single-family type approach. In turn, this morning we will discuss such ancillary programs as section 235, and you will find that a great portion of the Members of Congress no longer have relevancy with that because they come from areas in which ownership is not at issue. It is affordable housing, rental or whatever, or affordable shelter that is of concern to their constituents.

So today's hearing is important because it is the result of testimony we have heard in the past from GAO and from HUD. Finally, as a result of that testimony in 1992 the Secretary was put under considerable pressure because HUD could not pick up 80,000 mortgages without having a problem. Congress did the best it could from this level to try to coordinate the RTC and the FDIC with their vast \$400 billion in notes. We said it would be \$400 billion in 1989, but it was a mixed bag that included all kinds of real estate ownerships from single family to multifamily to commercial to all kind and business.

So we have a problem. The problem, however, is human-made and, therefore, is susceptible to human resolution. We hope that this will be a followup hearing. It is not the first, it is a followup, which will be followed by more in which we will be able to work in conjunction with and cooperation with those that have the very, very onerous task of trying to administer this myriad of problems.

I think the most significant thing that I am concerned with is that we do not make the fatal mistake I have seen since I was on the city council 40 years ago, of confusing cutting with economy. In my definition, true economy in governmental administration, is making sure that we get 100 pennies worth out of each dollar as intended instead of cutting for show. I have seen what has happened, beginning with my own hometown, in 1953, exactly 40½ years ago. I saw the costly amount that 5 years later the city had to make up which at one time was being touted as an economy-booster and a savings mechanism.

I see this occurring today. When we had testimony this year, last year and the year before, and for several years, the GAO was advising us that what was needed at HUD was oversight of their financial operations and, of course, the administration at that time was fully against it.

I recall vividly in 1972, when President Nixon was elected, that by December he announced he was appointing George Romney as Secretary of HUD. President Nixon stated his intention was to do away with some of the costly programs that were not working. Some housing programs had sunk into scandal, one of which was section 235. Secretary Romney announced he intended to cut back 10,000 personnel from the personnel list. To no avail, we pointed out that maybe scandal existed in Chicago, maybe in Detroit, but in our area it worked beautifully.

The reason it did not work in some areas was because of the cut-back in personnel. You could not have the counseling that was necessary to get those families, who for the first time were coming to, by virtue of 235, to own a home and live in a home. Counseling was done in some areas, including my district, and it worked beautifully. You still have families today that express their gratitude for

the Section 235 Program. Some say that it enabled them to send their kids to college and still own a home.

In comparison, one of the reasons given for the FHA disarray, either in disposition or what have you, is that there has been inadequate personnel and unprepared personnel. Then I see where the Vice President says that we are going to reduce the number of Federal employees by 200,000 and that it will have to be apportioned among the departments. I am interested in seeing how this can be done in such a way as to effectuate true economy, savings, and still maintain the level that is required for efficient administration of the programs. It concerns me vastly because I think we are headed for a dilemma.

So with that, I will recognize the witnesses, unless one of you has a time constraint.

[The prepared statement of Chairman Gonzalez can be found in the appendix.]

Well, you came in so quietly, Congressman. Thank you very much for attending. Do you have any remarks you wish to make.

Mr. WATT. Thank you, Mr. Chairman.

I simply wanted to say that I congratulate the chairman on having this hearing and share the chairman's concern about across-the-board cuts of personnel and staff for agencies, particularly agencies which have already been decimated by cuts in the last 12 years, and those are typically the agencies that deal with housing and community development issues and people issues.

So I wanted to try to be here this morning and hear the witnesses and look forward to hearing them. I may have to leave right after they testify because of another commitment, but I look forward to hearing what they have to say and working with them to try to meet this challenge of possibly fighting off folks who believe that cutting is necessarily synonymous with saving and economy.

Thank you.

Chairman GONZALEZ. Well, thank you, sir.

Does any witness have a time problem? OK, I don't want to discriminate against anybody, so why don't I recognize you in the order that we listed the panel. I recognize Mr. Connors, and thank him once again for helping this subcommittee. You were here last, when, in June?

Mr. CONNORS. June and July, yes.

Chairman GONZALEZ. OK.

STATEMENT OF JOHN J. CONNORS, DEPUTY INSPECTOR GENERAL, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; ACCOMPANIED BY CHRIS GREER, ASSISTANT INSPECTOR GENERAL FOR AUDIT

Mr. CONNORS. Mr. Chairman and members of the subcommittee, we are pleased to be here today to provide our office's perspective again on staffing needs at the Department of Housing and Urban Development, and, more specifically, FHA and Ginnie Mae. With me today is Chris Greer, our assistant inspector general for audit.

Inspector General Gaffney sends her apologies for not being able to attend today. She had a previous longstanding commitment on the west coast.

I have provided our full statement to the subcommittee and ask that it be included in its entirety.

Chairman GONZALEZ. Yes. Let me say that each one of your statements will be, as you give it to us in writing, included in the record. I will ask unanimous consent that myself and other members have the privilege of placing introductory remarks, formal remarks, in the record.

Mr. CONNORS. Thank you.

I do, however, have a few remarks that I would like to make now.

Our office, over the past several years, has reported in our 6-month reports to the Congress that staffing inadequacies are a problem and prime contributor to major operational and programmatic problems at HUD. We commend you for holding these hearings, as we did in June and July of this year. We are believers in the IG's office and that congressional oversight is necessary.

Last year we testified before this subcommittee that resource management was one of the ten biggest problems facing HUD and Secretary Cisneros. We would like to repeat that testimony again today, because although the Department is moving aggressively to address the problems, we remain concerned about the systemic weaknesses at HUD, including the human resource management issue.

In June we testified HUD did not have sufficient staff to carry out its operations as currently structured. Additionally, it does not have a plan for either acquiring additional competent staff or restructuring operations based on the resources it has. Of special concern is the increased risk of fraud and abuse, as HUD shifts much of its program delivery functions to others without the level of monitoring needed to prevent, detect, or correct problems. Undetected and uncorrected problems hurt HUD's credibility, escalate program costs and diminish program benefits.

As you well know, HUD's staffing over the past 10 years has declined significantly while new programs and additional responsibilities have been added. The combination of increased need and decreased staff hampers new program delivery as well as the effective monitoring and closeout of ongoing and terminated programs. It has also led to an increased reliance on contractors to perform many of the program delivery functions previously performed by HUD staff.

The complexity of the staffing challenge is further compounded by HUD's unwieldy organizational structure that discourages accountability, the geographic dispersion of staffing skills not necessarily commensurate with program workloads and needs, the fragmented program and financial management systems responsibility, the abandonment or curtailing of work measurement systems to even determine what those resource needs are, and last, but not least, hiring and resource constraints which restrict FHA and Ginnie Mae reacting to changes in economic or market conditions in a timely businesslike manner.

In this era of budget austerity, it is unlikely HUD will significantly increase its resources; therefore, the challenge for the Secretary will be to better use existing resources through various means. To meet this challenge, the Secretary has established var-

ious task forces to study the issues and provide him with recommended actions.

The above conclusions we reached based on work that our office has done as well as that of the General Accounting Office and even internal evaluations done by HUD program staff. We believe that FHA and Ginnie Mae programs are particularly affected by staffing problems.

Very briefly, we have performed several audits over the past year which we believe demonstrate the problems in FHA. On the multi-family side of FHA, we conducted audits of its loan servicing activities for multifamily projects. We also did a multifamily asset management review, a Title II prepayment and preservation audit, a bond refunding for section 8 projects, and delegated processing for multifamily. In each of these areas, we found problems with resources, either a lack of staff or imbalances of staff at the field offices visited.

One particular audit, the last one I mentioned, was delegated processing. Delegated processing was designed in order to free up HUD staff and, in effect, what our audit has shown was because of the sloppy work done by the contractors who were performing these tasks, HUD staff had to spend more time in correcting it and reviewing that work than it should have.

Other audits that we had done were in the Single-family Program where we completed an audit of the Direct Endorsement Program, the Single-family Property Disposition Program which you earlier alluded to, and a review of mortgagee monitoring and loan servicing. Last, but not least, in Ginnie Mae, we have had a concern over the past number of years of the staffing levels that Ginnie Mae currently has in its reliance on contractors to carry out its functions. Ginnie Mae now has contractors to oversee its contractors, and these are issues that affect contract administration of Ginnie Mae.

Mr. Chairman, we believe that these audits clearly show that the human resource management issue is a critical one. The list of audit reports showing significant risk of potential losses in the billions of dollars cannot be ignored. Yet, a reality check would indicate that HUD, like most Federal agencies, will experience staff cuts and not staff gains.

Secretary Cisneros and his management team have set out to aggressively pursue long- and short-term actions to deal with such realities. Steps have been taken to attack the problem on several fronts. Legislative changes are being proposed, programs are being studied to be reinvented or restructured and procedures are being implemented to improve staff utilization. However, at this point in time, I cannot predict the degree of success. We can say that HUD is making a valiant attempt to address these problems.

As we have said before, this is a formidable challenge and if it is to be successful, the Secretary will need all the help he can get from OMB, the Congress, HUD employees, program participants, and from the general public. Within FHA, for example, Assistant Secretary Retsinas and his staff are evaluating ways to reorganize operations and restructure programs as a means to protect the insurance funds from further losses. Similar efforts are being undertaken by other Assistant Secretaries.

Committees have been established and are responsible for reporting directly to Deputy Secretary Duvernay. The Secretary has also repeatedly stated he wants his team to be held personally responsible and accountable for their progress. I have heard him say this in testimony before the Senate as well as I believe this subcommittee. He reemphasizes this at each principal staff meeting and insists on progress reports from his Assistant Secretaries.

To aid the Secretary in assessing progress, the Office of Inspector General, over the next 6 months, will evaluate the effectiveness of those efforts that are under way and report on progress being made. These results will be reported to the Secretary as well as to the Congress in our next semiannual report for the period ending March 31, 1994. This assessment will not only include human resource management but two other crucial problems in the Department: Namely, systems and management controls.

Mr. Chairman, thanks again for inviting us to testify today. This concludes my statement and we would be pleased to answer any questions.

[The prepared statement of Mr. Connors can be found in the appendix.]

Chairman GONZALEZ. Well, thank you very much, profoundly.

Ms. Williams-Bridgers. Thank you again.

STATEMENT OF JACQUELYN L. WILLIAMS-BRIDGERS, ASSOCIATE DIRECTOR, HOUSING AND COMMUNITY ISSUES, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Ms. WILLIAMS-BRIDGERS. Thank you. It is good to see you again, Mr. Chairman.

Mr. Chairman, and member of the subcommittee, I am pleased to be here today to participate in the subcommittee's hearing on staffing needs at the Department of Housing and Urban Development. GAO has often reported on the longstanding and persistent staffing problems at the Department, yet HUD has been unable to address this critical issue which has rendered the Federal Government vulnerable to billions of dollars of losses.

In response to a congressional request to examine staffing issues specific to the Government National Mortgage Association, we recently made recommendations to HUD, OMB, and the Congress, recommendations designed to allow Ginnie Mae the flexibility to staff and manage its growing workload so that it will be better able to focus on areas of financial risk and exposure to loss.

The congressional subcommittee for which we did this work was concerned about the ability of Ginnie Mae to oversee its issuers and the \$416 billion in mortgage backed securities it had outstanding as of August 30 of this year.

As you know, Mr. Chairman, in recent years, several Federal loan guarantee programs have come under scrutiny because of downturns in the real estate market and allegations of mismanagement and fraud. Some of these programs have incurred significant losses, such as the \$2.5 billion lost by FHA in fiscal year 1992.

In our June 30 report to the Senate, we concluded that Ginnie Mae had successfully supported financing for low- and moderate-income housing and, at the same time, generated revenues of \$1.4

billion during a recent 6-year period after paying its operating expenses. However, even though Ginnie Mae is a government-owned corporation and is responsible for monitoring and managing a potentially large Federal liability, Ginnie Mae's managers do not have the authority to hire the personnel necessary to manage Ginnie Mae's assets. This is because Ginnie Mae's decisions to hire employees, like other organizational units in HUD, are subject to the staffing limitations imposed by HUD and OMB.

What Ginnie Mae does have is the flexibility to obtain contractor personnel. Consequently, within the mid-1980's, Ginnie Mae began to have difficulty overseeing the financial condition of its issuers and issuers began to default on payments to investors. Ginnie Mae had to rely on contractors to develop and operate management information systems, to manage and dispose of acquired mortgage portfolios and to monitor issuers of Ginnie Mae mortgage-backed securities. Ginnie Mae continues to rely on contractors for virtually all of its administrative and management functions.

For example, Ginnie Mae's early warning management information system that is designed to track issuers financial condition was developed and is being operated by Ginnie Mae's largest contractor. This contractor also conducts the annual reviews of all of Ginnie Mae's issuers. According to Ginnie Mae, in fiscal year 1991, it spent approximately \$62 million on contracts for services, using about 566 full-time equivalent contractor personnel.

While contractors are needed to carry out many of Ginnie Mae's functions, Ginnie Mae must have the core capability, in other words, the sufficient number of trained and skilled personnel, to properly manage and be accountable for its work. However, HUD's recent study of Ginnie Mae staffing concluded that Ginnie Mae does not have sufficient staff to properly manage its workload, which has increased significantly more than its staffing levels over the past 5 years.

In addition, although the HUD study estimated that Ginnie Mae would need from 10 to 16 staff to manage its workload and run a REMIC Program, HUD requested and received only 3 additional staff to run the REMIC Program in fiscal year 1994.

Providing additional staff to Ginnie Mae by taking such staff from other HUD programs could adversely affect these other programs because HUD does not currently have sufficient staff resources to perform its most necessary functions.

Ginnie Mae's staffing needs must be considered without regard to HUD's personnel limitations. If Ginnie Mae's staffing needs continue to be tied to HUD's personnel ceilings, Ginnie Mae may not be able to focus on areas of risk and exposure to the extent that it should and may have difficulty responding to future management challenges. Moreover, Ginnie Mae could have difficulty managing a REMIC Program, which, if effectively run, would allow Ginnie Mae to compete in a changing secondary mortgage market.

To ensure that Ginnie Mae has the flexibility to manage its growing workload, to respond to the changing market, and to create new products, we recommended in our June report that the Secretary of HUD and the Director of OMB work together to consider Ginnie Mae's staffing needs and provide for those needs without regard to personnel limitations imposed on HUD.

We also recommended that the Secretary of HUD report to the Congress within 60 days of the issuance of our report on the options that it considered and the actions that they have taken to provide Ginnie Mae with the resources it needs to operate in a businesslike manner while reducing the overall financial risk to the Federal Government.

The Secretary and the Director have not yet responded to our recommendations.

We also suggested in our report that the Congress should monitor HUD's and OMB's efforts to resolve Ginnie Mae's staffing problems. If HUD and OMB do not resolve this problem, we suggested that the Congress may wish to consider directing them to provide Ginnie Mae with the necessary staff without regard to HUD's personnel ceilings.

Mr. Chairman, while my testimony today has focused on the need for greater staffing flexibility to improve Ginnie Mae's management, we have noted in prior reports and testimonies, as has the HUD inspector general, that staffing levels departmentwide are a longstanding HUD deficiency that has remained largely unsolved. Work that we have recently completed, as well as our ongoing work, point to some of the symptoms and the consequences of HUD's staffing constraints.

For example, in our ongoing work that we are performing at your request, we have found that HUD is functioning as a landlord for a huge inventory of multifamily properties involving about 128 full-time HUD staff whose salaries amount to about \$5.8 million annually. HUD was never intended to be a landlord nor is it adequately staffed to fulfill that role.

Our work indicates that shortage of HUD staffing has contributed to delays in the sale of foreclosed multifamily properties, although, as we testified before your subcommittee in May, the shortage of section 8 assistance has no doubt had a comparatively greater impact on HUD's ability to dispose of the properties and preserve units for low- and moderate-income tenants.

HUD's inspector general and Price Waterhouse have pointed to inadequate staffing as one of several factors that have contributed to HUD's inability to effectively service its troubled loan portfolio, the precursor to growth in the foreclosed properties inventory.

Mr. Chairman, this concludes the summary of my statement. I would be happy to respond to any questions that you might have about Ginnie Mae's staff as well as other FHA staffing problems.

[The prepared statement of Ms. Williams-Bridgers can be found in the appendix.]

Chairman GONZALEZ. Thank you very much and thank you for your tremendous help here.

Well, Ms. Alvarez, congratulations and welcome aboard. Your communication indicates that this is your first appearance before a congressional committee.

Ms. ALVAREZ. It is.

Chairman GONZALEZ. Well, I am glad that we have that honor. We have shared your concerns, certainly from the beginning of the notice of your appointment. Since the subcommittee created that provision in last year's act having to do with what we call the GSEs, or government supported enterprises, and in realizing the

history of that amendment, we share the concern about the ability to set up an adequate agency there.

So thank you very much for responding to our invitation. I hope we can, as we go into the future months, be helpful and mutually cooperating.

STATEMENT OF AIDA ALVAREZ, DIRECTOR, OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. ALVAREZ. Thank you, sir. I really appreciate the opportunity to be here and, as you said, this is my first official appearance before Congress. I am the director of an agency that is an arm's length agency of HUD, reporting directly to Congress on matters of safety and soundness.

Thank you for being here as well, Mr. Watt.

I wanted to also mention that yesterday was the anniversary of the signing into law of the Federal Housing Enterprises Financial Safety and Soundness Act that created this office.

Mr. Chairman, your leadership in support of the legislation creating the office is consistent with your lifelong dedication to protecting the interests of the taxpayer. OFHEO's mission is to guard against the consequences of the financial risks to the two very large, very important government-sponsored enterprises: The Federal National Mortgage Association, Fannie Mae, and the Federal Home Loan Mortgage Corporation, Freddie Mac.

Let me say from the outset that I welcome this opportunity to testify because I have great enthusiasm for the challenge before me and I also have concerns which warrant discussion. In my written testimony I outline those concerns in detail. I am simply going to briefly refer to them.

One concern, of course, is the fact that no other financial institution's regulator is under an FTE staffing cap. In our case, we are capped at 45 full time employees, governmental employees. OFHEO's budget and staff ratio has been set at a level well below that of other regulators, and I have a chart here today, and you have it in the written testimony as attachment B, which outlines the differences in staffing for us versus other regulators.

No other Federal regulator is required to go through an appropriations process for its operating budget, and that, of course, affects our staffing flexibility and exposes us to external influences. The legislatively mandated deadlines are ambitious and certainly the staffing constraints may have an effect on our ability to deliver in a timely fashion.

I am proceeding aggressively to establish OFHEO and to fulfill the mandate of the law. It is clear that when this Congress created OFHEO the intention was for us to be comparable to other financial institution regulators in mission, authority, and in structure. Relative to the other financial regulators, OFHEO's research task is unprecedented.

Other financial regulators set capital standards based on fixed ratios. They are just beginning to apply portfolio simulation models to adjust these standards to account for interest rate risk. We are the first regulator called on to develop and apply portfolio simulation techniques to set basic capital standards for our industry.

To do this, we must establish the most sophisticated fixed income and mortgage research capability in the regulatory community. This is an ongoing task in a dynamic market. There are new products and new programs being introduced regularly.

Mr. Chairman, Mr. Watt, I wanted to call your attention to a story in the *Wall Street Journal* today in the money and investing section. There is a headline here: "Firms face big losses on IO investments." Those are interest-only strips.

And I quote: "Part of the problem in recent months is that investors didn't take into account some big changes in the consumer mortgage market." This is an example of what can happen with a different headline: Taxpayers, the public faces losses, because we didn't have the staffing and the capability to monitor in an ongoing way a dynamic market where there is constantly an introduction of new products and new programs.

In the best of all possible worlds, OFHEO would have been fully staffed by now and quickly working on the mandated task. However, the process of recruiting highly talented technical and specialized staff is demanding and time-consuming under the best of circumstances.

In my written testimony, I have included a chronology on page 3, which gives you some idea of what it takes to start a new agency. Hiring has to wait a lengthy process to obtain authority, procedures have to be developed, compensation standards instituted, a physical facility, a home found and innumerable other requirements all carried out with minimal staff.

To implement the legislative mandate, I have organized the office into four functional units which will respond to the mission and develop the strategic plan, design the systems, and phase in the personnel to respond to the legal requirements.

From the outset, my plan has always been to create a lean, flat organization. Individual staff will be expected to have diverse skills, exhibit flexibility and function in a variety of areas. I can tell you that I personally roll up my sleeves and perform any job that needs doing and I expect no less from my staff.

In evaluating the merits of hiring governmental employees versus consulting staff, there are four areas that were highlighted in the testimony, areas where we have some concerns. For one, and you have heard this from my colleagues here, consultants cost more, and we have examples of how much more, sometimes two to three times as much.

Government, I believe, should not be in the business of paying to develop consultants expertise. Our canvassing of the consulting community leads us to believe that there is nobody out there who can hit the ground running without a lengthy startup period to develop this model, and frankly, we are vulnerable, if a consultant decides to walk away with this very marketable experience gained at public expense.

There are issues of confidentiality and conflict of interest with consultants. The information they are looking at is proprietary data in many cases to Fannie Mae and Freddie Mac. Many have consultant relationships with them, and that has to be addressed. And I don't have to tell you that it takes a lot longer to hire consultants than full-time staff and that that is a leadtime that we

have to factor in, in terms of being responsive to the deadlines in the legislation.

I place great value on austerity and efficiency, but I don't believe in sacrificing quality or creativity. As you made reference, Mr. Chairman, false economies carry an enormous price tag. OFHEO cannot risk being captured by the regulated entities because of a lack of resources and staffing preventing us from doing our job. Our mission is to protect the public.

I will continue to work tirelessly to create an office that ensures the financial safety and soundness of Fannie Mae and Freddie Mac. Mr. Chairman, Mr. Watt, this is a very big job, a great deal is at stake, I welcome your support and I look forward to working closely with you in the near future, and I am here to answer questions.

[The prepared statement of Ms. Alvarez can be found in the appendix.]

Chairman GONZALEZ. Thank you very much, Ms. Alvarez, and congratulations for the most competent manner in which you have assumed this very difficult task.

We were aware of the historical structural problems from the very outset, and that has to do with the, I would say, the bizarre budgetary happenings. I went into that history explaining why we are where we are in this and it is worse than anything Alice in Wonderland could conceive; nevertheless it is part of it. As you say in your statement, before you were appointed, the original HUD budget was presented, and the assumption was that your office would be handled and managed within the confines of HUD.

Before I go any further let me ask if Congressman Watt would like the opportunity to ask questions at this point? I will defer to you, since you are going to have to leave.

Mr. WATT. Thank you, Mr. Chairman. That is mighty generous of you. I just have a couple of questions.

I thought the testimony was very straightforward and reveals the magnitude of a problem that is even bigger than the one I had anticipated existed. I assume that both Mr. Connors and Ms. Williams-Bridgers, as I understand it, are with agencies that really have no—you are not under the control of HUD or any of its personnel; you are independent bodies that have responsibility for making these determinations without the influence of Secretary Cisneros. So I place even greater credibility in your statements.

I take it that if you have a series of responsibilities that are to be performed, you have several different options about how to perform them. You can either hire the staff to move the 300 bricks from one place to another, or you can contract that responsibility out to somebody else to move those bricks, or you can simply let the bricks stay where they are and not do the task.

And as I understand what you are saying, a lot of this is being done by contract employees because restrictions have been placed on the number of full-time employees within the agencies, the work is actually being contracted out. Where does the money come from to do this contracting out if the money is not in the budget to hire the full-time equivalent employees?

Ms. WILLIAMS-BRIDGERS. In Ginnie Mae's case, Ginnie Mae is a revenue-generating agency. It charges fees to the issuers of mortgage-backed securities. Therefore, it is fairly self-sustaining.

What happens is in the appropriations process, the Appropriations Committee authorize a certain spending level for Ginnie Mae full-time staff. Ginnie Mae finances that spending level, and the expenses needed to pay contractors, through the fees that are generated by the issuers. Any revenues that are generated in excess of these operating expenses for Ginnie Mae, in effect, reduce the deficit.

Mr. CONNORS. Mr. Watt, if I may add something to that. One is I think in your example, one of the things the Department needs to do, including Ginnie Mae, is determine whether those bricks need to be moved. Is there any risk?

And that is one of the things the Department has had a difficult time doing is prioritizing those functions of what has to be done with the resources they have. It may be perfectly appropriate to leave those bricks where they are and get on to something a lot more important. And that is something the Department I think has to decide.

The other comment I want to make is overall departmental staffing. You, yourself referred to the term full-time equivalents, FTEs. That staff is pretty much provided by OMB and through the Appropriations Committee. So the number of people are limited. You give the money for the contracting, OK, but you set the limit on the staffing.

Mr. WATT. So, in effect, to make up for the need for additional staffing because the Appropriations Committee has set certain limits on employees, the agencies are simply going around that process and contracting out the same work that would otherwise be done internally?

Mr. CONNORS. I am not sure they are going around the process, because I think the appropriators, as well as OMB, know that that task has to be done and they know that that contract money is in that budget. So I would not say the Department is going around anyone or anything.

Mr. WATT. You have the ability to compare the cost of hiring an employee against the cost of hiring a contractor. Suppose you are hiring an employee for 40 hours a week and you were contracting that same work out. What would be the approximate cost differential?

Ms. WILLIAMS-BRIDGERS. I think Ginnie Mae has estimated that it costs three times as much to hire a contractor as it does to bring on a full-time equivalent, in-house person.

Ms. ALVAREZ. Right.

Ms. WILLIAMS-BRIDGERS. But there are several issues associated with Ginnie Mae's or other agency's abilities to hire the skilled personnel. Salary caps, for one, affect the ability of organizations like Ginnie Mae to hire the type of skill and to pay them salaries comparable to what they would otherwise receive in the private sector.

But also, Ginnie Mae would argue that contracting is smart business for them in certain situations. For example, take the case of Ginnie Mae's Asset Management Office. Ginnie Mae would argue that it is not a property manager, that it is not skilled, nor should it develop the skills in-house to manage portfolios acquired through defaulted issuers. So it makes smart business sense, according to Ginnie Mae, to hire that skill from the private sector.

Mr. WATT. Are you implying that if there were a representative of Ginnie Mae here, they would be on the opposite side of this issue? They would be saying—

Ms. WILLIAMS-BRIDGERS. Yes, for certain tasks that it performs; asset management is one where Ginnie Mae will argue that contracting out is justified.

Mr. WATT. But on a gross basis, would they agree with you or disagree with you?

Ms. WILLIAMS-BRIDGERS. No. On the issue of asset management, I think I am in accord with what Ginnie Mae would argue.

However, Ginnie Mae would argue that what they need is the core staff in-house in order to monitor the contractors, and to develop information systems to target its resources, or the contractor's resources, to high-risk areas. One problem that prevails across many of HUD's programs is that they are not able to adequately monitor the contractors that they hire to perform functions that they do not have the in-house staff to perform.

Monitoring is essential, it is critical. We found that the lack of adequate monitoring led to defaults in FHA's Direct Endorsement Program. Specifically, FHA was not able to adequately monitor its lenders who underwrote its loans, which contributed to that \$2.5 billion loss that was incurred by FHA.

Mr. WATT. Mr. Chairman, I know my time is up, but if I could ask two more questions, just to follow up on some things.

You mentioned that HUD was in the landlord business unintentionally, never having really anticipated being there. Is that a service that they would argue, as does Ginnie Mae, would be more efficiently contracted out, and do they have the funds to contract it out, if so?

Ms. WILLIAMS-BRIDGERS. HUD would probably first say that they wish that they never had to perform that particular task, of managing the foreclosed properties.

Mr. WATT. But it is there. I mean it is a reality.

Ms. WILLIAMS-BRIDGERS. Yes. They do currently rely to a great extent on contractors to help in managing that foreclosed property inventory. They currently don't have the staff in-house; they won't be able to obtain that staff in-house, so they will increasingly have to look to the contractors to perform those tasks.

Mr. WATT. Is it your office's assessment that that is a function that would be more properly performed with full-time employees or contracted out?

Ms. WILLIAMS-BRIDGERS. I would say right now that the skills base is more readily available in the private sector, so that it would be more appropriately handled by contractors at this point.

Mr. WATT. Mr. Connors, let me return to one kind of off-the-cuff comment you made that I didn't want to let you kind of get off the hook by saying it without following up.

Mr. CONNORS. I appreciate that.

Mr. WATT. You said that if you had the stack of bricks there, the first thing that has got to be determined is whether you need to move the bricks. The implication in that statement was that HUD is performing, or some of these agencies are performing tasks that don't need to be performed, and I think you said that. Have you made an assessment of what part of HUD's activities might fall

into the category of moving bricks that need to stay in the same place as opposed to being moved some place else?

Mr. CONNORS. In certain of the audits we have done, we have made that conclusion. Let me give you an example in the multifamily area where HUD is required—and we get into this a little bit in our audit of multifamily loan servicing.

The HUD field representatives have to go out and monitor that project, review those financial statements, and do a whole host of activities where HUD services that project. There are requirements in HUD that say that that field representative will do that for every project that HUD has insured.

Now, as the chairman knows, there are many old luxury projects, section 207, I believe they were, that were insured many years ago where the mortgages are current; the project is in good physical condition, and probably doesn't need any visit or monitoring review by a HUD staff person. And in that particular instance, that project doesn't need to be monitored, and those resources should be devoted to where HUD is the landlord, where the technical assistance is needed to be given. And that was my off-the-cuff remark on the pile of bricks.

Mr. WATT. What percentage of HUD's work overall would you think would fall into that category? And finally, do you see the Secretary taking steps internally to reduce that percentage as he gets ahold of this agency?

Mr. CONNORS. Let me answer the second question, because I think it addresses the first. That is part of the Secretary's reinventing effort, as I understand it.

The Chief Financial Officer, Ed DeSeve; the Assistant Secretary for Administration, Marilynn Davis; the inspector general, Ms. Gaffney, all serve on committees, and what they are actually doing is looking at the way HUD does business and what those risks are that are associated with functions. As the chairman mentioned earlier, he referenced the Vice President's report, there is no way HUD could take those types of cuts without totally changing the way it does business.

The only other comment I would like to make, if you would bear with me, your question on contracting before, which Ms. Williams-Bridgers answered. One other problem with contracting, when the contract is over, the contractor leaves and takes that expertise with them. They haven't left it, OK? Whereas an employee who carries out that function and has that expertise stays there.

Mr. WATT. Mr. Chairman, you have been very gracious in deferring your time to me to let me honor a commitment that I made, and I appreciate again your having this hearing, and I look forward to maybe addressing one more question.

Is there any of that inefficiency, or those bricks that are being moved from one place to another that don't need to be moved that we need to be addressing legislatively as opposed to the Secretary addressing administratively?

Mr. CONNORS. I would, and in my opinion think there are some, and I think we need to develop our office—our office has to be prepared to furnish you our ideas on that, as well as I think the Secretary needs to also let you know. I know that issue has been looked at in the Department, or it is under discussion. I am not

sure there is any type of report, but I do know it has been looked at.

Mr. WATT. Thank you very much.

Chairman GONZALEZ. Congressman, before you leave, let me say that it wasn't so much generosity as the fact that you were the only one that showed up. So I think both of us ought to be thankful no more showed up. You get more time.

But before you leave, this paradox or dilemma, you know, about the bricks, reminds me of what I have used from time to time, particularly since the beginning or the advent of the so-called Gramm-Rudman-Hollings charade.

I read many years ago of the fathers of the mythical village of Podunkville who had made a decision. They met and said we have to build a new schoolhouse, but we have the following two conditions: One, you cannot tear down the old schoolhouse until you have the new one built and; two, you must build the new one out of the material from the old one. And that is where we are today, actually, if you look at it. It is sad.

I think, also, before you leave, that Ms. Williams-Bridgers referred in her testimony to this recommendation the GAO made to the Secretary, as well as the OMB. Again, I have been here since the development of OMB as such, even though there was an Office of Budget before, it wasn't until actually a late development that OMB developed tremendous power.

Then I was also here at the founding of HUD, as well as the other Departments that followed. The Congress has allowed itself to become one—Congresses have wanted to have it both ways too, not only in this area, but almost every other, including war. They don't want to exercise their constitutional responsibility, which in my opinion is inescapable and nondelegable.

And on the other hand, what I have been told by colleagues since the 1960's is oh, well, you know, gosh, what do you want to do, Henry? Suppose the President is right and the Communists win? Then you see, we will all get blamed.

So I said, well, sir, you want the President to go ahead and fall on his face so then you can say, well, it was his fault. That is pretty much what has happened. And in this case, what I see now is a compounding. I am very disturbed, because if you want to look at it from a partisan standpoint, you may. Of course, I have been a Democrat; therefore, I am a member of the majority that controls the House, supposedly the composition and the leadership of committees, and the forging of policy, but it doesn't happen that way. The whole thing has been diffused, and not one person has the ability to either define policy, formulate it, or carry it out. I think the point we have reached here is where you have administrative leadership, in other words the executive branch, that hasn't shaped policy. It saddens me. This is not a partisan statement, because I have been critical of incumbents of the White House that have been both Democratic Party victors as well as Republican Party.

It saddens me, because the net effect is that you have confusion. I often quote St. Paul: "When the trumpets give an uncertain sound, who then can prepare himself to battle?" We have this confusion where we have a recommendation from our oversight arm

that we should try to see what we can do to get two executive branch agencies to work together.

Well, I know that the reality is that you have power tussles. OMB has been very, very chary to preserve their power, yet it hasn't really brought about the intended purposes. All of these structures and all of the posturing that has gone on, including Gramm-Rudman, have not resulted in reducing the deficit.

Instead of that, you had an exponential increase. In fact, since Gramm-Rudman's inception in 1986, and to 1990, when, in effect, it was preempted with the Budget Summit budget agreement, you had almost \$2 trillion added to the deficit. That is the reason that yesterday's hearing before the full committee was very appropriate, particularly with reference to Ms. Alvarez.

So I wanted to thank you very much for your participation in the hearings, not only of the subcommittee, but the full committee. You are here every opportunity you have, and I wanted to thank you for it, Mr. Watt. I wish you well this weekend.

Mr. WATT. Thank you very much.

Chairman GONZALEZ. I have always taken the position that if we do our part, then we don't have to worry about the executive branch infringing on our independence, coequality, and separateness that I have always been very jealous of.

Now, I have endeavored always to work with anybody that has this onerous responsibility, and I have been respectful of the fine line of demarcation between the policy or the political and the administrative or the executive. I have done that from the beginning. Since I was on the city council, I was very, very scrupulous in respecting that line. I don't know to what extent it would be possible for us to bring about a closer relationship between HUD and OMB. Goodwill and good working relationships and certainly knowledge of the individuals, such as the current Director of the Office of Management and Budget, who served with us in the House long enough so that I know him very well may help. In fact, we worked with him in very difficult situations as the Budget Committee chairman.

We go back to what I said in the beginning. When the Budget Reform Act was passed, it was passed out of the then-universal agreement that the Congress really didn't know how to budget. But, where are we? Let's compare today with 20 years ago and before when you had these old nesters, you know, chairmen seniority. Did we have continuing resolutions from month to month? Did we have supplemental, or even dire emergency supplemental as we now take for granted? No, we didn't.

The first supplemental was in 1966 on account of Vietnam when President Johnson asked for \$650 million. It became a big argument, and even the opponents of the war in the Senate said, well, we are against the war, but we are going to vote for this because we are not going to deny the soldier boys the means with which to defend themselves. We didn't order them there, we can't bring them out, but golly, we are not going to send them away, so that is how they got that supplemental.

But it was a radical request, and it took a lot of agonizing. I remember the chairman of the Appropriations Committee, who was

a fellow Texan, going to the Senate. Where are we now? We are in worse disarray than anyone would have imagined.

I am sure those old nesters have turned over in their grave 20 times to see this. How can you have an efficient functioning administration of a multibillion dollar operation if you don't know from 6 months to 6 months what your budget is going to be? In that sense I want to point out that I recognize the contribution of the Congress to this confusion and disarray.

Now, despite that, it doesn't mean that we have to cease from keeping on and trying to work this out, and I pledge to you that once we have the Secretary's response to the recommendation, and we get the copy that I believe you said we should be entitled to get, I can assure you, I, for one, will get on it immediately.

In the meanwhile, given the fact that we know and are acquainted with the Secretary, it will enable us to contact and discuss with HUD without any formal declaration for reports or what have you. At this point, though, what I am concerned with is the dilemma here posed by Ms. Alvarez' position. I think that it is going to rest on the Congress and our ability to influence the appropriation process, which sometimes becomes very limited. In regards to what Inspector General Connors said, you know, earlier with respect to Ginnie Mae, we will have to work with the Appropriations Committee.

Now, in your testimony you gave us a copy of the letter from OPM in which they said we recognize you as entitled to schedule A employees. That is fine as far as it goes.

Ms. ALVAREZ. Two years.

Chairman GONZALEZ. But it is like contracting out. I have gone through the contracting out in the case of defense. During the first 6 years I was in office, my district consisted of the entire county, so I had all of the defense posts and bases. Some of the most historical bases in our Nation were in Bexar County. I have seen the folly and the waste of unwise contracting out. The necessity of the administrator of defense, in view of the congressionally imposed mandate, had to reduce personnel in reaction to having a cap, not only on personnel, but on expenditures. The administrator also had to respond to the Air Force directorates; the Congress, through the Armed Services Committee, who were trying to fine-tune management by straightjacketing even the interplay between these directorates. They tried to stop moving funds from one area into a more needed area.

Ms. ALVAREZ. That is right.

Chairman GONZALEZ. Believe it or not, it took 2 years of struggle before we were able to remove those restrictions and bring back the flexibility that was there in the beginning. It is very disappointing to see this happening in this section of the Federal Government's administrative functions. I used to say that in the area of housing, accounting, and financing were so different, and that the book-keeping in housing was so different from defense. But in this respect, I see the worst aspects of it.

The one question I have is, what effect does a cap on your full-time equivalents have on your overall plans?

Ms. ALVAREZ. It has a considerable effect, Mr. Chairman. First of all, as you know, the money, the funding for my office does not

come from the public—from the taxpayer. It is an assessment on Fannie Mae and Freddie Mac, which is typical of what other regulators do, they assess the institutions they regulate.

Frankly, it is slowing me down. I have had to revisit my budget, revisit my plan. It means that yes, I do have to do much more contracting. Employees that I would have hired as full-time employees to perform the functions of the office now will cost two to three times more.

That creates a shortfall in my budget. I already anticipate that the budget that I requested of \$10.6 million cannot cover the expenses of hiring those employees as contractors without sacrificing something else; and so it affects my overall plan. It really is something I had not anticipated.

Chairman GONZALEZ. It would, of course, affect your office. The legislative mandate in the law, in the meanwhile, would be affected, wouldn't it?

Ms. ALVAREZ. Very much so, sir. To begin with, it was an ambitious timetable. Because as you see from the written testimony, the governmental process for actually creating a new agency requires a leadtime that you must go through before you can even begin to do the job, and if you layer that with the requirements now to do more extensive contracting, again, it delays me and affects my ability to meet the timetable.

Chairman GONZALEZ. Well, even though, as you say, the operational revenues are derived from fees, you are the only Federal or quasi-Federal regulatory agency that goes through the appropriations process.

Ms. ALVAREZ. It really presents a bit of a dilemma, because I believe that your intent in supporting and being one of the principals in this legislation was to have an independent regulator, and as you well know, going through an appropriations process, not only means that you don't have flexibility, that if there were an emergency situation, you might be constrained by the appropriations process.

It also means that there are external influences that could make determinations about your budget and staffing that might be contrary to the greater interests of the good, of the public. No other financial institution's regulator goes through this process.

And I have to say that I report to Congress, I also report to the Secretary; I have quarterly reports, I report to OMB, I am subject to GAO audits, so I am under considerable scrutiny to be efficient and productive.

Chairman GONZALEZ. As you said in your statement, you are directly accountable to the Congress.

Ms. ALVAREZ. I am indeed.

Chairman GONZALEZ. And not to the Secretary.

Ms. ALVAREZ. Correct.

Chairman GONZALEZ. All right. Now, that ought to tell you that despite the fact you want to give me credit, I don't know that I want to accept the paternity of that amendment, which gave rise to this particular setup.

Again, I go back to the city council. We have a fundamental law of the city as a city charter which, of course, I memorized, and I was a strict adherent to it. It provided that the fine line of demar-

cation existed between the policymaking, the council, and the administration. In fact, it had a section that said that improper interference by a member of the council was an impeachable offense, and it also mandated that the city manager would appoint all the directors, police, and so forth. The manager, however, did not appoint the public utility regulator, but he was to account to the city council every year by providing an audit of the public utilities in the city. Well, that position was never filled. We had a constant fight and, of course, the members of the council were not sophisticated to see the fine points. They could care less, and so there was actually, as the charter intended, no public utility. The regulatory oversight, never has, even to this day, been accomplished.

I had the fight with the fact that my city is probably the last one in the English-speaking world that still has the vestiges of the old system. The city water board for instance was structured in such a way that it was based on an indenture entered into in 1922 for 40 years, and the board of trustees were self-perpetuating.

The council didn't appoint them; they appointed themselves, and they were the trustees of those interests holding the indenture. Interestingly, the city public service company, which is the gas and light company, is still structured that way. I left the council and left that fight started and unfinished.

The city water board fight I won after 3 years. It was a tough, mean fight and it took an election of a new council and all to bring about the change. It was very unusual, given the structure of the charter as with respect to city council manager, directly to the council, rather than to the manager—from within the office, it may lead to problems.

So in this case, though, HUD is the site for the operations of the agency.

Ms. ALVAREZ. I am actually moving.

Chairman GONZALEZ. You are? All right.

Ms. ALVAREZ. Actually, sir, as you know, I did introduce a revised budget that reflected my definition of the office, redefinition of the office. And so one of the decisions I made was to move us out of the HUD facility. The Office of Thrift Supervision is in a downsizing mode. They have space, we are leasing space from them, we will be there probably certainly before the year's end.

Chairman GONZALEZ. Well, I am glad to hear that. Very good.

Well, it may be that we can end up being helpful.

Ms. ALVAREZ. I am sure you can.

Chairman GONZALEZ. I wanted to pledge to you the fact that I certainly, for one, intend to help as we proceed.

Ms. ALVAREZ. Thank you.

Chairman GONZALEZ. I will be in touch with you and communicate with you.

Ms. ALVAREZ. Thank you, sir.

Chairman GONZALEZ. I have some questions, but I don't think it would necessitate holding you here beyond the noon hour, and it is almost that hour. At this moment and for the record, I believe that your statements were totally complete for the purposes of this hearing. Any particular question I have, which I will have one or two, would be more anticipatory perspective, asking for recommendations.

If it becomes apparent that perhaps a legislative action is recommended, it is imperative we know about it as soon as possible, because we have the task of reaffirming and extending all of the affordable housing laws next year, certainly before the end of the next session.

We want to get on that, and incorporate as much as we can. In the meanwhile, we have the rescission message from the executive branch which will bring about some additional mandated decisions. There is no way we can escape it.

We are mandated, the leadership says, to take these cuts. The administration finally sent over its package yesterday, which included the rescission instructions. Some of the actions recommended will be carried out administratively. It is within the power of the administration to do so.

As in the case of HUD's regional office staffing, as I interpret the message I saw yesterday, the regional setup as we understand it will be done away with. So it will be necessary to make sure that we look at this carefully.

Mr. Valencia, who is the staff director of the subcommittee, has given me this summary of an outline we had been given yesterday. The Department of Housing and Urban Development is saying that it can save \$750 million by improving the management and sale of multifamily loans and properties, which the Senate pretty much has adopted. This is one of the recommendations in the Secretary's legislative package.

What the administration is saying is that they are going to accept that. I am not sure. This is part of the rescission plan to streamline and consolidate HUD's headquarters, regional, and field offices. Now, it does say over time, it doesn't give us a timespan, it will save \$167 million.

The plan provides incentive payments to homeowners and lending institutions to refinance HUD-subsidized mortgages with high interest rates. That is a projected total savings of \$302 million. Mr. Valencia says that it is referring to section 235, but that brings to mind something that I was going to ask you before we broke up.

Some of the members of the subcommittee have introduced bills with respect to the so-called underwater mortgages or refinancing where the value of the property has depreciated to the point where it exceeds the mortgage outstanding. They are proposing what I would say is a sort of an FHA bailout.

So if, in principle, the administration is saying we want to provide incentive payments to homeowners and lending institutions to refinance HUD-subsidized mortgages with high interest rates, it seems to me that there is a calculated risk, because of the instability of the interest rate market. There is no stability in that market.

Anything can happen. The only way it can go now is up, and if it does you know what happens to this. There is also a current huge state of affairs in the secondary market that is now being impacted with this phenomenon created by the so-called low-interest levels currently enjoyed. However, their estimate as to savings is \$302 million.

Reduce excessive rent subsidies by freezing rent increases for 1 year under the Section 8 New Construction and Substantial Rehabilitation Program. Total savings projected: \$558 million.

Improve management efficiency by consolidating two similar programs, the Section 8 Certificate and Voucher Programs, both programs provide rental assistance to needy individuals and families.

Now, what happens to the 30 percent level? Well, the rental contributions for the low-income tenants will be affected. Now, to what extent we can do anything about it remains to be seen. Rescissions are rescissions.

Now, I said at the outset that I am a Democrat; however, up until now, I don't think it would have made too much difference if Mr. Bush had been reelected. What I was afraid of, I think, is happening. The so-called Democrats are really Republican-light, "lite beer" Republicans. I hope I am forgiven by the executive branch, but frankly I can't help but say that when I am confronted with a rescission order.

If you have any comments, I am particularly concerned. There are several Members that have introduced bills, not just one, on what they call—it is amazing how beautiful phrases can be coined—underwater mortgages, which is right, they are under water, they are drowning, and I have had letters from citizens that have that dilemma. They have this mortgage, they have this house, and they don't know what to do.

We have had an introduction to what I consider to be a nasty feeling toward poor and helpless citizens. We blame them. I don't think that from the beginning of our Nation the question was whether government should intervene or not. That was always decided affirmatively.

Even in the beginning, the construction of the canals were subsidized by the government, along with the railroads, public lands, and so forth.

The big question is not, shall government intervene? The question is, on behalf of whom? And when you have control of the processes, either directly or indirectly, by tremendous vested interests, it is very difficult to work for the public wheel. The greatest interests are the greatest number.

And so back home, I visit, and I see. I can't tell you how demoralizing—to a Depression kid like myself—it has been to see this, and to see families about to be foreclosed on, and thrown out of their homes. In fact, in 1 week we were able to salvage one. Then I had three others, two of which were the poor in my district, and in an adjacent district. It was painful in the case of one to have her tell me that shortly after the death of her husband—even though she is working and has an income that for San Antonio is above average—she realized that she was going to have difficulty. She went to HUD, because the loan was FHA.

She told me that the lady there told her, well, you know, I had the same problem, and I just found out I couldn't meet the payments, so I lost the place and I went to live with my mother. You ought to do the same.

Now, how do you think I felt when I am the author of the 1983 Home Mortgage Emergency Assistance Act, patterned on the Homeowners Loan Cooperation Act of the 1930's that saved hundreds of thousands of American families their homes. I saw it languish and die in the Senate after we got it out of the House.

It was the only so-called new program that was approved during the entire Reagan administration of 8 years. We had to go to bat when we had that act. The mortgage bankers came up here and said it is not necessary. We don't enjoy foreclosing. We would rather save it, and we are going to forebear.

Well, let me tell you, they were licking their chops with these widows. They almost had poverty. They weren't given any leeway. They weren't offering that woman any chance to restructure anything.

Eventually she brought it to my attention, and fortunately, I was there, reachable. The rest is history, and the fact that I had been fighting for two administrations of HUD to work the TMAP. I was part of the TMAP law of 1978 when we first saw the little current which wasn't as visible as it became in 1982, but it affected only HUD or FHA.

My bill in 1983 was for conventional home mortgages. So fortunately, it makes me happy, we were able to bring around banks. In fact, I brought it to the attention of Secretary Cisneros, and I think he had a lot to do with making sure that that little gal went back to HUD and found out that there was a program for mortgage assignment. They were able to work out a suitable arrangement, and she has her home.

Now, if anybody that says that the day when widows are being thrown out is gone, you send them to me. It just seems to me that it shouldn't have taken a Member of the Congress to go in there and help. I have never understood that, but then that is why we are here, we are supposed to be accessible.

Has any one of you, and particularly Mr. Connors, examined the bills and exactly how they would base the financing or refinancing in that type of a situation? Are you familiar with that, what they now call underwater mortgages?

Mr. CONNORS. Well, it is my understanding that the portion of the bill you mentioned before, the incentive payments to subsidize as it relates to 235, this has been proposed a couple of previous times, and it was an outgrowth, I believe, of back when the hearings were being held by Congressman Lantos' committee on 235s. And at that point in time I believe we may have testified that loans were out there that were at 12, 14, 16 percent, and by refinancing at the levels which back then I think were 8 or 8.5, there would have been significant savings to the Department.

The Department tried to implement those provisions, but there was no incentive for lenders or homeowners to refinance. There was no monetary incentive. I mean most of those homeowners are on assistance, they don't have the wherewithal to refinance and pay those closing costs.

The lenders weren't going to do it out of the goodness of their hearts, so there had to be something built in to provide that incentive for refinancing action to take place. I believe that is what this particular bill will do, would provide that incentive.

The net savings, I don't know where they come up with the \$302 million. But there will be a net savings, because you are going to be refinancing some of these old mortgages down to probably 7, 7.5 percent, and the Department's assistance payment or subsidy is

still going to be based on a formula. So I do think there can be some real savings that can be achieved under that plan.

Chairman GONZALEZ. What about when you have these mortgages where the net residual marketable value of that ownership is way below the exposure on that mortgage? How will that be resolved unless you have some means of providing the subsidy?

I don't know, I have not reviewed the bill.

Mr. CONNORS. I am not sure either. And I don't believe that is unique to the 235 Program or anything else. You can have that same situation with multifamily projects, where the appraised value or the current value is much less than what the mortgage amount is.

And there needs to be something, I would think, to prevent people from walking away from that project. You know, when it gets to cost you more than an asset is worth, it is pretty easy to walk away.

Chairman GONZALEZ. Well, in fact, we had a section—it is now in my district, as of this year—where you had almost 2,000 walk away from their homes. And, ironically, some of them moved over to another side of town and went into another arrangement. They just left this other place because their mortgage payment was way up there and they could go to the other part of town and get into a new arrangement and have a much lower monthly payment.

But in the meanwhile, there was a dilemma, and the city councilman for that district saw me. When it first developed, it was not in my district, so I tried to work with the Congressman who did have that district. It was mostly the fact that the city councilman was reporting vandalism and other undesirable activities in these abandoned areas, which naturally would happen.

So, with that, unless any one of you has an additional observation or recommendation, we will thank you, as we did in the beginning, for your great patience and close it out exactly at noon.

Thank you very much.

Mr. CONNORS. Thank you.

Ms. WILLIAMS-BRIDGERS. Thank you, Mr. Chairman.

Ms. ALVAREZ. Thank you.

Chairman GONZALEZ. The subcommittee stands adjourned until next Wednesday in this hearing room at 10 a.m.

[Whereupon, at 12 noon, the hearing was adjourned.]

APPENDIX

October 29, 1993

OPENING STATEMENT

CHAIRMAN HENRY B. GONZALEZ

OCTOBER 29, 1993

STAFFING NEEDS IN SELECTED HUD DIVISIONS

THIS HEARING WILL FOCUS ON THE STAFFING NEEDS OF THE FEDERAL HOUSING ADMINISTRATION, THE GOVERNMENT NATIONAL MORTGAGE ASSOCIATION, AND THE OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT. I REMAIN VERY CONCERNED ABOUT THE STAFFING SHORTAGES WITHIN THE FEDERAL HOUSING ADMINISTRATION BECAUSE OF THE EFFECTS THESE STAFFING SHORTAGES MAY HAVE ON THE FINANCIAL STABILITY OF THE INSURANCE FUNDS -- SUCH AS THE MUTUAL MORTGAGE INSURANCE FUND AND GENERAL INSURANCE FUND -- ADMINISTERED UNDER THE FHA.

I REALIZE THAT OUR COUNTRY IS FACING GREAT FISCAL CONSTRAINTS PARTICULARLY AS A RESULT OF THE LAST TWELVE YEARS OF MISGUIDED PRIORITIES, YET HUD HAS CONSISTENTLY SUFFERED STAFFING CUTS AS WELL AS BUDGET CUTS. FOR INSTANCE, HUD HAS GONE FROM A TOTAL OF APPROXIMATELY 17,345 FULL TIME EQUIVALENTS (FTEs) IN FISCAL YEAR 1980 TO 13,275 (FTEs) TODAY.

AT THIS TIME, THE FEDERAL GOVERNMENT MUST ALSO RESPOND TO A RECENTLY ISSUED EXECUTIVE ORDER WHICH REQUIRES ALL EXECUTIVE DEPARTMENTS OR AGENCIES WITH OVER 100 EMPLOYEES TO REDUCE NOT LESS THAN 4% OF ITS CIVILIAN PERSONNEL POSITIONS. I ALSO UNDERSTAND THAT THE OFFICE OF MANAGEMENT AND BUDGET DEFICIT REDUCTION PROPOSAL MAY CONTAIN FURTHER STAFF REDUCTIONS WHICH I BELIEVE ARE PREMATURE AND MAY JEOPARDIZE THE EFFECTIVENESS OF OUR HOUSING AND COMMUNITY DEVELOPMENT PROGRAMS.

WITHOUT DOUBT, THE FHA, OTHER HOUSING PROGRAMS, AND THE DEPARTMENT IN GENERAL HAVE SUFFERED THE IMPACT OF PAST BUDGET CUTS. THE COSTLY EFFECTS OF STAFFING REDUCTIONS BECOMES PAINFULLY APPARENT WHEN REVIEWING THE MULTI-FAMILY PROPERTY DISPOSITION PROGRAM -- A LOSS THAT MAY EXCEED \$11.9 BILLION. THE FEDERAL GOVERNMENT MIGHT HAVE AVOIDED THIS CRISIS WITH GREATER STAFFING RESOURCES.

I AM LOOKING FORWARD TO THE TESTIMONY OF HUD'S DEPUTY INSPECTOR GENERAL WHO WILL REVEAL AND DISCUSS OTHER PROBLEMS THE FHA HAS CONFRONTED AS A RESULT OF STAFFING REDUCTIONS. I UNDERSTAND THAT THESE REDUCTIONS HAVE NEGATIVELY IMPACTED THE SINGLE-FAMILY AND MULTI-FAMILY LOAN PROGRAMS UNDER THE FHA. THE FINANCIAL STABILITY OF THESE PROGRAMS IS IMPERATIVE TO THE CONTINUATION OF GOVERNMENT ASSISTANCE TO LOW-AND MODERATE-INCOME HOMEBUYERS. THE FHA PROGRAM, AS WELL AS THE GOVERNMENT NATIONAL MORTGAGE ASSOCIATION, ARE PRODUCTIVE AND ESSENTIAL GOVERNMENT PROGRAMS WHICH NEED TO BE ADEQUATELY STAFFED.

I ALSO WELCOME TESTIMONY FROM THE GAO WHO WILL DISCUSS A RECENTLY ISSUED REPORT THAT REVIEWS THE STAFFING NEEDS OF GINNIE MAE. I WOULD HOPE THAT HUD WOULD USE THIS VALUABLE ASSESSMENT AS A BASIS TO DEVELOP FUTURE STAFFING POLICY.

MS. AIDA ALVAREZ, A RECENTLY CONFIRMED PRESIDENTIAL APPOINTEE HAS ALSO JOINED US HERE TODAY IN HER NEW ROLE AS THE DIRECTOR OF

THE OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT. SHE IS THE FIRST REGULATOR OF FANNIE MAE AND FREDDIE MAC SINCE WE CREATED HER OFFICE IN THE 1992 HOUSING ACT. APPARENTLY, MS. ALVAREZ HAS ALREADY FACED SEVERAL OBSTACLES EARLY ON IN ATTEMPTING TO STAFF HER OFFICE. SHE HAS RAISED CONCERNs ABOUT HER ALLOTMENT OF 45 FULL TIME EQUIVALENTS -- 15 LESS FULL TIME EQUIVALENTS THAN SHE REQUESTED -- WHICH SHE RECEIVED UNDER THE APPROVAL OF FY 1994 VA-HUD APPROPRIATIONS ACT. WHILE HER FULL BUDGET REQUEST WAS FULFILLED, SHE IS HELD TO A CONGRESSIONALLY IMPOSED STAFFING CEILING THAT MAY LEAVE THAT OFFICE UNDERSTAFFED, AND FORCED TO CONTRACT OUT SOME OF HER OFFICE FUNCTIONS.

IN HER TESTIMONY, I HOPE THAT SHE WILL ELABORATE ON THIS STAFFING ISSUE. I ALSO HOPE TO HEAR WHAT MS. ALVAREZ PLANS TO ACCOMPLISH DURING THE UPCOMING YEAR AS DIRECTOR OF OFHEO AND REGULATOR OF FANNIE MAE AND FREDDIE MAC.

WE MAY NOT FINISH THIS HEARING WITH THE SOLUTION TO THE PROBLEM OF STAFFING SHORTAGES, HOWEVER WE WILL LEAVE HERE TODAY WITH A BETTER UNDERSTANDING OF THE NEEDS OF TWO WELL-ESTABLISHED HOUSING PROGRAMS -- THE FHA AND GINNIE MAE -- AND ONE NEWLY-ESTABLISHED PROGRAM -- THE OFFICE OF FEDERAL HOUSING ENTERPRISE AND OVERSIGHT. THIS HEARING IS PART OF THE SUBCOMMITTEE'S EFFORTS RELATING TO HUD'S STAFFING NEEDS AS A WHOLE.

WITH THAT, I LOOK FORWARD TO YOUR TESTIMONY.

Statement of John J. Connors, Deputy Inspector General
Department of Housing and Urban Development
Accompanied by
Chris Greer, Assistant Inspector General for Audit

Before the Subcommittee on Housing and Community Development
of the
Committee on Banking, Finance and Urban Affairs

October 29, 1993

Mr. Chairman, and Members of the Subcommittee, we are pleased to be here today to provide the Office of Inspector General's perspective on staffing needs at the Department of Housing and Urban Development (HUD) and, more specifically, at the Federal Housing Administration (FHA) and the Government National Mortgage Association (GNMA). Our office has, for several years, reported in our Semiannual Reports to Congress that staffing inadequacies are a prime contributor to major operational and programmatic problems at HUD. Thus, we want to thank you for holding these hearings today to focus on this long standing and critical concern.

Last July, we testified before this Subcommittee that Resource Management was one of the ten biggest problems facing HUD and Secretary Cisneros. We would like to repeat that testimony today because, although the Department is moving aggressively to address the problems, we remain very concerned about the human resource management issue. At that time we stated:

HUD does not have sufficient staff to carry out its operations as currently structured. In addition, it does not have a plan for either acquiring additional competent staff, or restructuring operations based on the resources it has. Of special concern, is the increased risk of fraud and abuse, as HUD shifts much of its program delivery functions to others, without the level of monitoring needed to prevent, detect or correct problems. Undetected and uncorrected problems tarnish HUD's credibility, escalate program costs, and diminish program benefits.

Over the past 10 years, at the same time that major new programs have been introduced, HUD staff has declined from over 17,000 to 13,500 people. The combination of increased need and decreased staff hampers new program delivery, as well as effective monitoring and close-out of ongoing and terminated programs. It has also led to increased reliance on contractors to perform many of the program delivery functions previously performed by HUD staff.

The complexity of the staffing challenge is further compounded by:

- an unwieldy organizational structure that discourages accountability;
- geographic dispersion of staff and skills not necessarily commensurate with program workloads and needs;
- fragmented program and financial management systems responsibility;
- abandonment of work measurement systems for determining resource needs; and

-hiring and resource constraints which restrict FHA and GNMA reacting to changes in economic or market conditions in a business-like manner.

In this era of budget austerity, it is unlikely that HUD will significantly increase its resources. Therefore, the challenge for Secretary Cisneros will be to better use existing resources through various means. To meet the challenge, the Secretary has established a task force to provide him with recommended actions.

The above statement was based on numerous OIG and GAO audit reports as well as internal HUD evaluations. We believe that FHA and GNMA programs are particularly affected by staffing problems.

We would like to summarize several audit reports we have issued, just in the last year, that highlight the need to address the staffing questions.

FHA-MULTIFAMILY PROGRAMS

Multifamily Loan Servicing

We reviewed program activities at six Field Offices within three Regions. We concluded that low staffing levels, incomplete training, poor supervision, and unreliable data systems all contribute to the increased potential for substantial losses to HUD and to substandard living conditions for tenants. Key among the weaknesses was staffing shortages. The ratio of projects serviced per loan servicer ranged from 105 in Detroit to 28 in Kansas City. We compared these staffing levels to two State Housing Finance Agencies and noted that the State ratios were 15 projects per loan servicer. Because of heavy workloads, HUD staff were unable to adequately protect HUD's financial interests.

Multifamily Asset Management

Our audit of FHA's financial statements for Fiscal Year 1992 showed that the pronounced increase in assets held and managed by FHA, without a commensurate staff increase, was severely hampering FHA's ability to minimize its losses in the applicable insurance funds.

More specifically, the audit showed that, at September 1992, HUD had about \$7.8 billion of assigned multifamily notes of which 75 percent were non-performing. This large percentage of non-performing notes presents significant problems because servicing these loans is more staff intensive and, with only 147 FTE's available for this work, the likelihood of losses is greatly increased.

In addition, attention paid to servicing and managing the assigned portfolio diverts staff from servicing the active portfolio. Multifamily loss reserves at September 30, 1992, were increased by \$6.4 billion and now total \$11.9 billion. Concerted efforts by HUD staff will be needed to minimize the actual losses. However, it is unlikely that staff will become available in the numbers and with the experience needed to deal with the growing number of risky loans. Thus, it is probable that HUD will incur substantial actual losses over the next few years.

Title II Prepayment and Preservation

We concluded that properties' preservation values were inaccurate and that owners were awarded excessive incentives. Staff shortages, coupled with a lack of comprehensive guidance and training, significantly increased HUD's future insurance risks and Section 8 subsidies.

Bond Refunding of Section 8 Projects

This report pointed out that HUD could realize an additional \$400 million in savings from Section 8 bond refundings by revising their current procedures. Because of staffing constraints, HUD adopted computation methods that were administratively easier but resulted in long-term losses to HUD.

Delegated Processing

This program was developed and designed to maximize staff capacity and to improve and enhance the delivery of multifamily insurance programs by contracting out various segments of the underwriting process. We audited the program at nine Field Offices within four Regions and noted that the objectives of the program were not being met effectively. Limited Field Office staff were spending their time reviewing and reprocessing unacceptable work submitted by the contractors. Consequently, the expected savings in staff time were not materializing.

FHA-SINGLE FAMILY PROGRAMS

Direct Endorsement Program

We reviewed program activities at eight Field Offices within four Regions and found that HUD needs to improve post-endorsement reviews to ensure the quality of insured single family mortgages. HUD reviews are not consistently identifying errors and irregularities in loans processed by lenders, or were not taking action against lenders processing deficient loans. Such failures increase the risk of losses to the Mutual Mortgage Insurance Fund. We attributed the problems to inadequate staffing, guidelines, training, and lack of an effective performance measurement system.

Single Family Property Disposition

As part of an audit verification, we reviewed steps taken by FHA management to correct past deficiencies in the use of contractors to manage FHA's owned single family properties. Our review at nine Field Offices in three Regions disclosed that staff resource constraints contributed to poor contracting functions, inadequate reviews of expense disbursements, and property appraisals and inefficiently monitored property managers. Effective procedures in this area could significantly reduce property holding costs and additional losses after the payment of insurance claims.

Mortgagee Monitoring and Loan Servicing

Our audit of FHA's financial statements for Fiscal Year 1992 disclosed that staffing shortages were the main factor responsible for FHA's failure to service single family notes and to monitor single family lenders to assure their underwriting decisions were appropriate.

GNMA PROGRAMS

Mortgage-backed Securities Program

With a staff of only 68 people, GNMA relies almost exclusively on contractors to carry out the asset management and program responsibilities associated with its \$422 billion Mortgage-backed Securities Program (MBS). With such a small staff, GNMA has difficulty in overseeing the various contracts necessary to perform its primary mission and assure that claims for services are reasonable.

Issues relating to weaknesses in contract administration have been raised in several audit reports we issued in the past few years. Most recently, our audit of GNMA's financial statements for Fiscal Year 1992 discusses that, although GNMA has taken steps to improve, significant weaknesses still exist in subservicer monitoring and in data system development and maintenance. As a matter of fact, GNMA's lack of staffing has led to a situation where contractors are used to monitor the performance of contractors that review a third level of program participants, known as security issuers.

Mr. Chairman, we believe that these short summaries clearly show that the human resource management issue is a critical one. The list of audit reports showing significant risks of potential losses in the billions of dollars cannot be ignored. Yet, a reality check would indicate that HUD, like most Federal agencies, will experience staff cuts not staff gains. Secretary Cisneros and his management team have set out to aggressively pursue both long- and short-term actions to deal with such realities.

Steps have been taken to attack the problems on several fronts. Legislative changes are being proposed, programs are being reinvented or restructured, and procedures are being implemented to improve staff utilization. At this point in time, we cannot predict the degree of success but we can say HUD is making valiant attempts to address these problems. As we have said before, this is a formidable challenge and, if it is to be successful, the Secretary will need all the help he can get from OMB, from Congress, from HUD employees, from HUD program participants, and from the general public.

Within FHA, for example, FHA Commissioner Retsinas and his staff are evaluating ways to reorganize operations and restructure programs as a means to protect the insurance funds from further losses. Similar efforts are being undertaken by other Assistant Secretaries. Committees have been established and report directly to Deputy Secretary Duvernay to coordinate these efforts.

The Secretary has also repeatedly stated that he wants his team to be held personally responsible and accountable for their progress. This is reemphasized at each Principal Staff meeting and progress reports are given. To aid the Secretary in assessing progress, we will, over the next 6 months, evaluate the effectiveness of these efforts and progress made. Our results will be provided to the Secretary and the Congress, in our Semianual Report for the period ending March 31, 1994. This assessment will not only include Human Resource Management, but the two other crucial problems in the Department, namely Systems and Management Controls.

Mr. Chairman, that concludes my statement and we would be pleased to answer any questions.

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Housing and
Community Development,
Committee on Banking, Finance, and Urban Affairs,
House of Representatives

For Release on Delivery
Expected at
10 a.m., EDT
Friday
October 29, 1993

GINNIE MAE

Greater Staffing Flexibility Needed to Improve Management

Statement of Jacquelyn L. Williams-Bridgers, Associate
Director, Housing and Community Development Issues,
Resources, Community, and Economic Development Division



Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to participate in the Subcommittee's hearing on staffing levels at the Department of Housing and Urban Development (HUD). My testimony is based on our recent report on staffing levels for HUD's Government National Mortgage Association (GNMA).¹ GNMA is a secondary mortgage market organization that guarantees securities issued by its approved mortgage originators (issuers) and backed by pools of mortgage loans insured by HUD's Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs (VA).

In recent years, several federal loan guaranty programs have come under scrutiny because of downturns in the real estate market and allegations of mismanagement and fraud. Some of these programs have incurred significant losses, such as the \$2.5 billion lost by FHA in fiscal year 1991. The federal government was obligated to pay the lenders for losses on defaulted mortgages that FHA had insured. Concerned about the ability of GNMA to oversee its issuers and the large amount of mortgage-backed securities outstanding (\$416 billion as of August 30, 1993), the Subcommittee on Housing and Urban Affairs, Senate Committee on Banking, Housing, and Urban Affairs asked us to (1) provide information on how GNMA has evolved to accomplish its mission, (2) identify recent management problems experienced by GNMA in overseeing its issuers, and (3) examine GNMA's response to its management problems.

In summary, GNMA's basic mission of supporting affordable housing has remained the same over time. However, the way it operates has changed substantially. In its early years, GNMA was primarily involved in subsidizing interest rates on mortgage loans to benefit low- and moderate-income borrowers. Subsequently, in the 1970s GNMA pioneered the mortgage-backed security (Ginnie Maes), which attracted investment capital to the mortgage market that could be loaned to homebuyers for FHA-insured and VA-guaranteed mortgages. Ginnie Maes have been successful in attracting capital that has helped finance about 14 million American homes.

In the mid-1980s, GNMA began experiencing difficulties in monitoring the financial health of its issuers. Because of weaknesses in its oversight of issuers, GNMA could not respond promptly to declines in regional real estate markets and other factors that financially weakened some of its issuers. As a result, since fiscal year 1987, GNMA, while remaining profitable, has become the manager of about \$22.4 billion in assets (mortgages) acquired from issuers that were unable to pay investors, thereby increasing the federal government's exposure

¹Government National Mortgage Association: Greater Staffing Flexibility Needed to Improve Management (GAO/RCED-93-100, June 30, 1993).

to loss. While the extent of the losses that GNMA has sustained or will sustain is not yet known, GNMA increased its loss reserve (estimate of probable future losses) to \$629 million in fiscal year 1989--up from \$44.8 million 3 years earlier--primarily because of issuers' defaults.

Beginning in 1989, GNMA began improving its oversight capability and taking steps to minimize potential losses. It developed a comprehensive management information system and started regular reviews of the hundreds of issuers that sell Ginnie Maes. Most of these improvements were made by hiring numerous contractors, because HUD's staffing limitations prevent GNMA from hiring additional employees. This inflexibility in staffing has created other concerns for GNMA managers. They have not been able to adequately monitor their contractors' activities and have been unable to respond to changing market conditions by creating new products that could lower financing costs for FHA and VA homebuyers.

Before I discuss the results of our GNMA review in detail, let me briefly outline the history of GNMA and explain how it operates.

HISTORY AND OPERATIONS OF GNMA

In 1968, the Federal National Mortgage Association (Fannie Mae), then a part of HUD, was partitioned into two entities. GNMA was created as a government-owned corporation² within HUD responsible for activities such as providing federal subsidies to borrowers to make housing more affordable and implementing a mortgage-backed securities program primarily for FHA and VA mortgages. GNMA's programs help provide financing for single-family, multifamily, and manufactured homes. Fannie Mae became a government-sponsored, but privately owned corporation, which today helps provide a secondary mortgage market for residential mortgages financed entirely by private sources.

GNMA's 781 issuers (mortgage bankers, savings institutions, and other financial intermediaries) are responsible for administering the mortgage pools backing the securities, including collecting mortgage payments from borrowers and making monthly payments to the owners of the guaranteed securities. Issuers pay various fees to GNMA to cover its costs and offset its future payments of claims under the guaranty. In the event that the issuer defaults in making timely payments of principal and interest to investors, GNMA makes the payment and takes over the issuer's entire GNMA portfolio.

²Government corporations are federally chartered entities usually created to serve public functions of a predominantly business nature.

GNMA operates like other organizational units of HUD in that its administrative, budgetary, and staffing decisions are integrated with those of HUD programs. However, as a government corporation, GNMA reimburses HUD for all of its personnel and administrative expenses. In fiscal year 1991 alone, GNMA's revenues exceeded its expenses by \$367.6 million. GNMA's president, who reports directly to the Secretary of HUD, oversees a staff of about 70 people.

GNMA'S ACTIVITIES HAVE CHANGED SUBSTANTIALLY

GNMA's earliest activities included operating a variety of mortgage purchase programs under the authority of its Special Assistance Functions. These programs were designed to help provide mortgage financing for affordable housing not being financed by the private sector and to counter declines in mortgage lending. Under some of these initiatives, GNMA purchased below-market interest rate mortgages from lenders and sold them to private investors at their market value. GNMA subsidized the difference between the purchase and selling prices. The subsidies enabled builders to obtain funds to finance affordable housing and offer lower financing costs to homebuyers and lower rents to tenants. Because of the perceived high cost of these subsidies, the Special Assistance Functions were terminated in 1983; in 1985, the Congress forgave \$12.7 billion in borrowings for GNMA from the U.S. Treasury to cover the accumulated cost of these initiatives.

In 1970, GNMA pioneered the mortgage-backed security, which has since become its primary means of assisting people with low and moderate incomes to obtain housing. The mortgage-backed security program involves GNMA-approved issuers that pool FHA and VA mortgage loans into securities guaranteed by GNMA and sold to investors. For a fee paid by issuers, GNMA guarantees that investors will receive timely monthly payments of principal and interest, no matter how the borrower or the issuer performs. Funds provided through the sale of Ginnie Maes are returned to the mortgage market and may be used to offer new loans to FHA and VA borrowers.

Because Ginnie Mae securities are backed by the full faith and credit of the federal government, they are attractive to investors. By 1980, GNMA had guaranteed 44,500 mortgage pools; by 1991, the number of guaranteed mortgage pools had grown to 270,947. Through 1991, the program has guaranteed a total of about \$702 billion in mortgage-backed securities representing almost 14 million homes. While GNMA's mortgage-backed securities program grew dramatically through the 1980s, GNMA's net revenues (after expenses) also grew totaled about \$1.4 billion for the 5 year period ending in fiscal year 1991.

MANAGEMENT PROBLEMS INCREASE GNMA'S EXPOSURE TO FINANCIAL LOSSES

During the 1980s, GNMA began to experience problems in overseeing the financial health of its issuers. Some GNMA issuers began to sustain losses brought on by economic distress and a resulting decline in regional real estate markets, a flawed FHA mortgage program design, and changes in VA's home loan mortgage guaranty practices. Other GNMA issuers failed to pay investors because the issuers mismanaged program funds. These four factors contributed to increased issuer defaults that exposed GNMA to greater financial losses and posed difficult management challenges.

Issuers' Financial Health Caused Problems for GNMA Management

While GNMA had few concerns about issuer defaults in the early years of the program, as the number of defaults grew they began to pose serious problems for GNMA. First, GNMA had to manage these portfolios by (1) collecting principal and interest payments from borrowers, (2) making payments to owners of the securities, and (3) awarding servicing contracts to firms, known as subservicers, that manage the portfolios. Second, issuers' defaults highlighted GNMA's need to develop ways to track delinquencies and foreclosures so that GNMA could respond promptly to early-warning signals about issuers that were experiencing financial difficulties.

GNMA officials told us that until recently they could not track important information on the financial health of issuers because they did not have adequate management information systems. Moreover, HUD's Office of Inspector General (OIG) reported in October 1989 that GNMA was not adequately monitoring its issuers' financial condition, in part because of staffing limitations.³ The report pointed out two cases in which GNMA was forced to provide more than \$20 million to cover issuers' losses because of its inadequate monitoring of poorly performing issuers. The report also criticized GNMA for continuing to allow two of its approved issuers to pool mortgages after FHA had stopped doing business with these issuers because they were no longer in compliance with FHA requirements. These issuers were responsible for 2,300 mortgage pools worth about \$3 billion. The OIG report concluded that these and similar situations were increasing the government's potential exposure to loss.

³Internal Audit of Review of Procedures for Issuer Monitoring,
Office of Inspector General (90-A0-171-0001, Oct. 4, 1989).

Factors Contributing to Issuers' Defaults
That Added to GNMA's Management Burden

Of the four factors that contributed to increasing issuers' defaults, declining regional real estate markets were considered by GNMA officials to be the major factor. During the mid- to late 1980s, an increasing number of borrowers began defaulting on their mortgages in economically distressed regions, particularly in the oil-producing states such as Texas and Oklahoma. When borrowers were unable to repay their mortgage loans, the issuers who pooled these mortgages became responsible for making payments to investors. The increased number of foreclosures and resulting losses weakened some issuers, causing them to also default. GNMA, in honoring its guarantees to investors, acquired these issuers' portfolios of defaulted mortgages, replenished funds in certain accounts, and hired subservicers to temporarily run the portfolios. The number of defaults by issuers peaked at 19 in calendar year 1989. In total, GNMA acquired portfolios of defaulted mortgages valued at about \$22.4 billion from its issuers between fiscal years 1987 through 1993. About half of this portfolio, \$11.5 billion, was acquired by GNMA in calendar year 1989.

Another factor that contributed to increased issuer defaults was FHA's multifamily coinsurance program, which provided mortgage insurance for multifamily rental housing projects initiated as a joint venture between FHA and private lenders. Loans valued at more than \$10 billion were coinsured through the program. The program functioned on a risk-sharing basis in which private lenders assumed approximately 20 percent, and FHA 80 percent, of the responsibility for potential losses incurred through defaulted mortgages.

Flaws in the program's operational structure and other problems contributed to a high default rate and subsequent losses to FHA totaling about \$2.4 billion through the end of fiscal year 1992. FHA officials and an independent accounting firm concluded that a major flaw in the structure of the program was that it allowed private lenders to pool coinsured mortgages into securities guaranteed by GNMA. When an individual lender defaulted on a coinsured loan, FHA was to pay the lender approximately 80 percent of the losses on the mortgage. However, if a lender that had pooled coinsured loans into Ginnie Maes defaulted, the GNMA guaranty rendered the federal government responsible for the lender's losses. Virtually all coinsured mortgages were pooled into securities guaranteed by GNMA, making it responsible for the 20 percent of all losses. However, GNMA is reimbursed by FHA for these losses. Therefore, in effect, the federal government became responsible for 100 percent of the losses. HUD issued final regulations terminating the program in October 1990.

VA's no-bid policy on property losses also had a similar effect on some of GNMA's issuers. The no-bid policy is a loss-limiting option that allows VA to take back the property or leave it with the lender, depending on which action is more in VA's financial interest. VA decides which option to follow after estimating and comparing the cost of taking possession of and reselling a foreclosed property with the cost of leaving the property with the lender and paying the lender the VA guaranteed portion of the mortgage loan. The VA guaranty program ranges from 25 to 50 percent of the loan amount, depending on the amount of the original loan, up to a maximum of \$46,000. VA's no-bid policy stems from the fact that VA guarantees only a portion of the mortgage and not the entire mortgage. When VA leaves properties with issuers, the issuers are responsible for the losses incurred above those guaranteed by VA. Because issuers' resources are reduced by such losses, the probability the issuer will default increases. When issuers default, GNMA is responsible for the portion of the losses not guaranteed by VA.

The last factor that contributed to GNMA issuer defaults occurred during the late 1980s, when GNMA took possession of a number of portfolios from issuers whom it placed in default because of fraud and mismanagement of program funds. For example, in 1989 one issuer with a \$7.1 billion portfolio mismanaged funds, forcing GNMA to fulfill its guaranty and make about \$35.4 million in payments owed to investors. In 1987, a principal of another issuer pleaded guilty to charges stemming from the embezzlement of \$11.4 million in federally insured mortgage funds in the largest GNMA fraud case prosecuted. GNMA had to make \$15.5 million in payments to investors in this case.

While FHA and VA assumed responsibility for most of the losses on the foreclosed mortgages they had insured or guaranteed, GNMA's costs increased as a result of issuer defaults. Once an issuer defaults, GNMA is responsible, as the cases discussed above describe, for making cash payments to investors for any shortfalls in the funds remitted by borrowers for mortgage principal and interest payments. In addition, GNMA incurred costs for payments of taxes and insurance, as well as costs associated with managing and disposing of portfolio properties, and paid all expenses associated with acquiring clear title to such properties. According to a GNMA official, the total costs incurred by GNMA will not be known until these assets are sold. However, primarily as a result of default expenses, GNMA was required to increase its loss reserves from \$44.8 million in fiscal year 1986 to \$629 million in fiscal year 1989 to pay for possible losses.

MANAGEMENT PROBLEMS ADDRESSED,
BUT STAFFING ISSUE REMAINS

Since fiscal year 1988, GNMA has taken several steps to improve its oversight of the mortgage-backed security program and dispose of assets acquired from defaulted issuers. Most of these actions were implemented by contractors hired by GNMA, since GNMA could not hire a sufficient number of employees because of HUD's staffing constraints. This increased reliance on contractors, coupled with HUD's staffing constraints, has caused concerns in HUD and GNMA. HUD is concerned about whether GNMA can monitor its contractors. GNMA is concerned about its ability to respond to future management challenges, such as developing new programs to benefit low- and moderate-income homebuyers.

Management Improvements Made by GNMA

In the late 1980s and early 1990s, GNMA developed and implemented an early-warning system to detect poorly performing issuers before they defaulted. It also created an issuer assistance group to conduct special reviews of issuers identified as poor performers and take steps to correct the problems. During the same period, GNMA also enhanced its monitoring of issuers by reviewing them annually for compliance. Another step taken by GNMA was to create an office of asset management to manage and dispose of the assets acquired from issuers that had defaulted.

Since the late 1980s, the number of issuer defaults and the value of assets acquired from such defaults have declined substantially. The number of issuer defaults declined from a high of 19 in calendar year 1989 to 5 in 1992. Between 1987 and 1992, GNMA sold the servicing rights to \$6.8 billion in mortgage portfolios acquired from defaulted issuers.

Staffing Issue Remains Unresolved

GNMA developed and implemented most of these improvements by contracting for staff because it lacked authority to hire its own employees. According to GNMA, in fiscal year 1991 it spent \$61.8 million on contracts for services, utilizing about 566 full-time-equivalent contractor personnel. Contractors now perform virtually all of GNMA's administrative and management information functions. For instance, GNMA's new early-warning system was developed and is being operated by the largest contractor. This contractor also conducts annual reviews of all GNMA issuers. GNMA has also hired additional contractors to help it dispose of acquired assets.

GNMA's managers have little flexibility in determining how to use their resources. Even though GNMA is a government corporation that reimburses HUD for its personnel and other costs

and operates at a profit to the federal government, its staffing level is restricted by staffing ceilings imposed by HUD and the Office of Management and Budget (OMB). HUD's staffing level decreased dramatically from 17,041 in 1980 to 13,032 in 1991. According to HUD's OIG, HUD programs are at considerable risk of abuse and loss, in part because of insufficient staff to perform necessary functions, such as monitoring, to prevent, detect, or correct problems.⁴ According to GNMA's past President, HUD cannot increase GNMA's staff without reducing staffing levels elsewhere in HUD. GNMA would like to use revenues it generates to increase its staffing levels without regard to HUD's staffing limitations, according to this official.

While HUD has at times increased GNMA's staffing levels, it has at other times denied requests for staffing increases from GNMA and proposed to cut GNMA's existing staffing level. GNMA's staff was increased from 55 to a high of 69 in fiscal year 1991 to help GNMA respond to increases in issuers' defaults. However, when GNMA requested 11 additional positions for fiscal year 1993, OMB approved HUD's plan, which reduced GNMA's existing staff to 60 by cutting 9 staff. According to a GNMA official, GNMA's accounting firm notified HUD that it might issue a qualified opinion⁵ on GNMA's financial statements if GNMA's staff was cut. The reason cited was that any reduction in staff would reduce GNMA's ability to monitor issuers, thereby increasing GNMA's financial risk. According to a HUD official, HUD amended GNMA's staffing allocation and restored eight of the nine positions HUD had planned to cut.

Staffing constraints limit the ability of GNMA to oversee its contractors. GNMA's largest contractor told us that GNMA does not have the resources to adequately review the contractor's work. According to a report issued by HUD's OIG in November 1989, HUD and GNMA have little assurance that critical program functions are properly performed and that subservicers' claims for services and costs are reasonable or valid.⁶ HUD's OIG reported that this monitoring weakness may have caused GNMA to reimburse subservicers for improper expenses. In its fiscal

⁴Statement of John J. Connors, Deputy Inspector General, Department of Housing and Urban Development, before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, May 4, 1993.

⁵A qualified opinion in this case means that except for the effects of the staffing cut, GNMA's principal financial statements present fairly, in all material respects, its financial position, among other things.

⁶Review of Government National Mortgage Association's Office of Asset Management, Office of Inspector General (90-A0-171-0003, Nov. 22, 1989).

years 1990 and 1991 financial statement reports, GNMA's accounting firm concluded that this problem was a "material" weakness partly attributable to personnel constraints imposed by HUD.⁷ In September 1991, GNMA hired a contractor to monitor its other contractors. However, in a March 1993 report on fiscal year 1992 operations, GNMA's accounting firm reported that "material" weaknesses continue to exist in GNMA's monitoring of contractors, in part because of constraints on GNMA's staffing levels. According to GNMA's most recent president, GNMA needs more in-house staff to monitor its contractors. He added, however, that increasing the number of staff is not an option for GNMA because of HUD's staffing constraints.

GNMA and HUD officials have expressed concerns about GNMA's staffing situation. GNMA officials believe that more staff are needed to monitor contractors, develop computer systems, and make long-range plans. In March 1992, the Deputy Secretary of HUD asked for a review of staffing and other issues affecting GNMA's operations. Because OMB also plays a major role in budget and staffing decisions, HUD's Deputy Secretary asked OMB to participate in the study. OMB helped HUD monitor the contractor that HUD hired to conduct the staffing study. According to the staffing study report, which was released on January 5, 1993,⁸ GNMA requires approximately 5 to 11 additional staff for the following reasons:

- The economy has been the worst since the late 1970s, thereby increasing the risk of issuers' failing and thus of GNMA having to fulfill its guarantees.
- GNMA's work load has increased significantly more than its staffing levels over the last 5 years.
- GNMA's increasing work load, combined with the effort it has had to expend to procure and monitor contract services, have resulted in GNMA's inability to effectively focus on areas of risk and exposure.

According to the study, the additional staff should be deployed throughout GNMA. However, their efforts should be focused (1) monitoring and overseeing issuers, (2) managing and disposing of defaulted portfolios, and (3) overseeing and managing contractors to identify areas for possible savings.

⁷According to the accounting firm, material weaknesses are those control weaknesses that can significantly impair the fulfillment of an agency's mission, deprive the public of needed services, and/or violate statutory or regulatory requirements.

⁸GNMA Capacity Study, KPMG Peat Marwick (Jan. 5, 1993).

In addition, GNMA would like to take advantage of new opportunities to benefit low- and moderate-income homebuyers. For example, GNMA officials would like to implement a program offering another type of mortgage-backed security called a Real Estate Mortgage Investment Conduit (REMIC),⁹ which could lower interest rates for FHA and VA borrowers. In the last few years, REMICs have become an important and profitable investment product for several secondary mortgage market agencies. In 1991, Fannie Mae issued over \$23 billion in REMICs backed by Ginnie Maes. HUD was concerned that, inasmuch as GNMA does not have the in-house expertise or staff to manage such a program, it would be forced to hire additional contractors to develop and run the program. In this regard, HUD's staffing study estimated the staffing impact on GNMA of adding a REMIC program. The report stated that GNMA would need five professional staff in addition to those already recommended by the study to manage its current work load. Also, other offices in HUD would require four to six staff to support a GNMA REMIC program, according to the study.

HUD announced in March 1993 that GNMA would begin developing and managing a REMIC program in fiscal year 1994. HUD requested three additional staff for this program in its budget submission for fiscal year 1994, but it did not ask for additional staff to address management problems related to insufficient staff. As of October 25, 1993, GNMA had not yet initiated the REMIC program.

CONCLUSIONS AND RECOMMENDATIONS

In conclusion, GNMA has successfully supported financing for low- and moderate-income housing and at the same time generated revenues--\$1.4 billion during a recent 6-year period after paying its operating costs. However, despite GNMA's status as a government-owned corporation and the potentially large federal liability inherent in its operations--\$416 billion--GNMA's managers have limited authority in adding personnel to manage their assets.

What GNMA does have is flexibility to obtain contractor personnel. Consequently, when GNMA began to experience problems in monitoring its issuers and issuers began to default on payments to investors, GNMA had to rely on--as it continues to rely on--contractors to develop and operate management information systems, manage and dispose of acquired mortgage portfolios, and monitor issuers. While contractors are needed for carrying out many of GNMA's functions, GNMA must have the core capability--a sufficient number of trained and experienced staff--to properly manage and be accountable for its work.

⁹REMICs are composed of mortgage-backed securities that have been divided into multiple-class securities with different maturities, interest rates, and prepayment risks.

However, HUD's recent staffing study concluded that GNMA does not have sufficient staff to properly manage its current work load and would need yet more staff to implement new initiatives. Providing additional staff to GNMA by taking such staff from other HUD programs could adversely affect HUD programs in that HUD currently has insufficient staff resources to perform necessary functions, according to HUD's OIG.

GNMA's staffing needs need to be considered without regard to HUD's personnel limitations. If GNMA's staffing needs continue to be tied to HUD's personnel ceilings, the agency may not be able to focus on areas of risk and exposure to the extent it should and may experience difficulties in responding to future management challenges. Moreover, GNMA could experience difficulties competing in a changing secondary mortgage market.

To ensure that GNMA has the flexibility to manage its growing work load, respond to changing markets, and create new products, we recommended in our June 30, 1993, report that the Secretary of HUD and the Director, OMB, work together to consider GNMA's staffing needs and provide for those needs without regard to personnel limitations imposed on HUD. We also recommended that the Secretary of HUD report to the Congress within 60 days of the issuance of our report on the options that it and OMB have considered and the actions they have taken to provide GNMA with the resources it needs to operate in a business-like manner while reducing the overall financial risk to the federal government. The Secretary and the Director have not yet responded to our recommendations.

We also suggested in our report that Congress should monitor HUD's and OMB's efforts to resolve GNMA's staffing problems. If HUD and OMB do not resolve this problem, we suggested the Congress may wish to consider directing them to provide GNMA with the necessary staff without regard to HUD's personnel budget.

In addition, your office asked us to address any staffing concerns that we may have identified in ongoing work. In work that we are performing at your request, we are finding, among other things, that HUD is the landlord for a huge inventory of multifamily properties that is managed by about 128 full-time HUD staff whose salary expenses amount to about \$5.8 million annually. HUD was never intended to play the part of a landlord, and has never been adequately staffed to do so.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions you or the other members may have.

(385401)



U. S. Department of Housing and Urban Development
Washington, D.C. 20410-0000

THE HOUSE BANKING, FINANCE AND URBAN AFFAIRS
SUBCOMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT

Henry B. Gonzalez, Chairman

Testimony of

DIRECTOR AIDA ALVAREZ,

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

Washington, D.C.

October 29, 1993

Chairman Gonzalez, members of the Subcommittee on Housing and Community Development.

A year ago, yesterday, the President signed into law the Federal Housing Enterprises Financial Safety and Soundness Act of 1992. That law conveyed the authority and outlined the responsibilities of the Office which I now have the privilege to direct. I am here at your request, Mr. Chairman, my first official appearance before Congress in my capacity as Director. As you know, the Office of Federal Housing Enterprise Oversight (OFHEO) is an arms length agency of the Department of Housing and Urban Development (HUD). On matters of financial safety and soundness, the Office reports directly to Congress.

Mr. Chairman, your leadership and support of the legislation creating this office is consistent with your lifelong dedication to protecting the interests of the taxpayer. OFHEO's mission is to guard against the consequences of financial risks to the two large, very important government sponsored enterprises (GSEs), the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). It is only fitting, given your leadership in the development and enactment of this legislation, that you should invite me here today to report on the activities of my office and to focus specifically on the issue of staffing.

Let me say from the outset that I welcome this opportunity to testify here because I have great enthusiasm for the challenge before me. I also have concerns which warrant discussion. As you know, Mr. Chairman, I submitted a revised FY94 budget which came out of the Senate appropriations committee leaving the requested funding level of \$10.6 million, but capping the full-time equivalent (FTE) staff positions at 45. My charge is to create a new federal agency to oversee a trillion dollar industry. Here are some issues affecting my ability to be effective:

- No other financial regulator is operating under an FTE cap.
- OFHEO's budget/staff ratio has been set at a level well below that of the other regulators. OFHEO regulates a trillion dollar industry with a \$10.6 million budget and a staff of 45. In contrast, the Office of Thrift Supervision regulates an \$800 billion asset base with a budget of \$212.1 million and a staff of 2,500.
- No other federal regulator is required to go through an appropriations process for its operating budget. (Our funding comes from an assessment on the government-sponsored enterprises, not public dollars).
- The legislatively mandated deadlines are ambitious. The legislation appears to require the promulgation of all final

regulations within 18 months of my having been named Director. That charge is challenging for a new agency with unprecedented research demands.

I am proceeding aggressively to establish OFHEO and to fulfill the mandate of the law. What follows is a more detailed description of the task before me.

UNIQUE CHALLENGE

As the first Director of the Office of Federal Housing Enterprise Oversight, I face the unique challenge of creating a new agency to monitor financial safety and soundness for two powerful GSEs. The on- and off-balance sheet assets of Fannie Mae and Freddie Mac together exceed a trillion dollars. These complex, technically sophisticated organizations have never been subject to review by an independent regulatory agency. (Previously an office at the U.S. Department of Housing and Urban Development had that responsibility).

COMPLEX REGULATORY CONTEXT

Similarity to Other Independent Regulators: Mission, Authority and Structure

The legislation intended OFHEO to function as an independent regulator. It is clear that Congress created OFHEO to be comparable to other financial institution regulators in mission, authority and structure.

For example, the Director of OFHEO is a 5-year term presidential appointee who, like the Chairman of the Federal Reserve, is an Executive Level II appointee. Like the other regulators, OFHEO is funded by assessments on the regulated entities. Similarly, this agency is exempt from Federal pay and classification requirements. Finally, OFHEO shares with other regulators a set of mission-related responsibilities: to adopt regulations, conduct examinations and initiate enforcement actions. (See Attachment A.)

Smaller Budget/Staff Ratio to Regulate Greater Asset Base

With a budget of \$10.6 million and 45 FTEs, OFHEO has oversight responsibilities for two enterprises which constitute a trillion dollar asset base--that is, one OFHEO employee for every \$23 billion in regulated assets. By contrast, the Office of Thrift Supervision oversees institutions with an \$800 billion asset base with a \$212.4 million budget and a staff of 2,500. The Federal Housing Finance Board (FHFB), regulates a \$165 billion asset base with a \$15.0 million budget and 124 FTEs. (See Attachment B.)

Unprecedented Research and Examination Task

OFHEO's research task is unprecedented. Other financial regulators set capital standards based on fixed ratios. They are just beginning to apply portfolio simulation models to adjust these standards to account for interest rate risk. We are the first regulator called on to develop and apply portfolio simulation techniques to set basic capital standards for our industry. To do this we must establish the most sophisticated fixed income and mortgage research capability in the regulatory community. We will also break new ground in the examinations area. The policy staff of traditional regulators is typically removed from the hundreds of examiners in the field. OFHEO will develop an approach in which highly sophisticated policy staff participate fully in the examination process.

AMBITIOUS GOALS AND TIMETABLE**Establishing a New Federal Agency**

My primary charge as Director is to accomplish the legislative mandate. Towards that end, I face the challenge of establishing a new federal regulatory agency. In the best of all worlds, OFHEO would have been fully staffed quickly and working on the mandated tasks. However, the process of recruiting highly talented and specialized staff is demanding and time consuming under the best of circumstances. As indicated by the chronology, hiring had to await a lengthy process to obtain authority, develop procedures, institute compensation standards, obtain a physical facility and innumerable other requirements, all carried out with minimal staff. Notwithstanding these constraints, it still is my objective to have all core senior staff on board by the end of 1993. What follows is a chronology of actions I have taken to establish OFHEO:

June 1, 1993: Director sworn in. Now has authority to begin establishing agency.

June 22, 1993: Secretary Henry Cisneros requested that the Office of Personnel Management (OPM) grant OFHEO Schedule A hiring authority.

July 14, 1993: Purchase order issued to hire consultant firm, the Hay Group, for a comparability study of the salary and benefits compensation plan (P.L. 103-550, Section 1315).

July 22, 1993: Approval obtained for Schedule A Hiring Authority (See Attachment C).

Aug 9, 1993: First two Schedule A employees hired.

Oct 18, 1993 Hay Group comparability study issued.

Oct 27, 1993 Formal lease negotiations for space begun with the Office of Thrift Supervision (OTS).

While I have been proceeding aggressively to establish OFHEO, it is clear that the most diligent efforts cannot overcome the delays inherent in governmental process. Accordingly, I have concerns about OFHEO's ability to achieve these ambitious legislatively-mandated deadlines.

**Fulfilling the Legislative Mandate:
Ensuring Safety and Soundness**

The Act provides that the Director is authorized, without review and approval of the Secretary, to carry out specific duties and functions. I am developing the staffing and infrastructure necessary to fulfill these responsibilities:

- Issuing regulations concerning capital and enforcement standards.
- Conducting examinations.
- Taking administrative and enforcement actions as necessary, including the appointment of conservators.
- Requiring the submission of data and reports necessary to the oversight function.
- Conducting research and financial analysis to establish capital standards and otherwise monitor safety and soundness.
- Reviewing compensation levels of the enterprises' executive officers.
- Reporting to Congress and the HUD Secretary.

**IMPLEMENTING LEGISLATIVE INTENT:
ORGANIZING TO FULFILL THE MISSION**

Over the course of the next two years, FY94 and FY95, OFHEO will take the critical steps to implement the legislative mandate. To that end, we have organized the office into four units that will develop the strategic plan, design the systems and phase in the personnel to produce the outcomes required by P.L. 102-550.

The Financial and Administrative Management unit ensures that the Office can function independently of HUD. It provides human resource management, financial management, strategic planning, contracting and procurement, information systems management and administrative support services.

The Policy, Research and Capital Standards unit is responsible for overall regulatory policy, and the research and analysis that produces risk-based capital tests and evaluates the impact of the enterprises' programs and business strategies. This unit will develop and continually enhance state-of-the-art financial analytic systems and establish the agency as an independent authority on the enterprises and the markets in which they operate.

The Examinations and Supervisory Oversight unit will work closely with the Policy Research and Capital Standards group. It must develop a strong examinations capability, informed by sophisticated expertise in capital markets, portfolio management, financial and regulatory accounting, and mortgage credit analysis. This group will take the lead in designing and conducting examinations of the GSEs.

Our Legal Affairs unit supports OFHEO's responsibility to issue regulations necessary to carry out its duties. It will be responsible for the legal aspects of rule-making, and advising the Director on the legal and policy implications of all operations and affairs of the office. It will provide knowledge of laws, rules and regulations pertaining to federal contracting and procurement, personnel, equal employment opportunities, ethics, administrative appeals processes and related general law matters.

THE REVISED FY94 BUDGET: ESTABLISHING A SELF-SUFFICIENT AGENCY

The organization I have just described was not contemplated in the original budget that was included with the HUD budget transmitted to the House on April 8, 1993, two months before I was formally appointed as Director. That budget, prepared by HUD staff, was based on the assumption that the work of regulating a trillion dollar industry would be done in-house, at HUD, as it had been in the past. (Prior to enactment of PL. 102-550 the regulatory responsibility for the GSEs resided in the Office of Policy Development and Research at HUD.)

On June 29, 1993, four weeks after I assumed office, the House passed the HUD/VA Appropriations bill with the original FY94 HUD request of \$5.7 million for OFHEO. My first responsibility, in order to implement the OFHEO authorizing legislation, was to evaluate that initial budget. That evaluation was shaped by assumptions fundamentally different from those of the HUD staff, by my belief that Congress intended OFHEO to be a truly effective and independent regulatory agency. For that, OFHEO needs the self-sufficiency and expert staff to operate responsibly and flexibly, free of the complicated

procedures of a large bureaucracy like HUD. Therefore my revised FY94 budget provided \$10.6 million and staffing of 60 FTEs.

The Senate Appropriations Committee reported out the bill with this revised budget. However, on September 22, 1993 the Senate passed the HUD/VA FY94 Appropriations bill leaving the funding level at \$10.6 million but including Amendment No. 912 limiting the full-time equivalent staff positions to 45 instead of the proposed 60, as well as imposing a \$5 million limit on the amount of funds available for personnel compensation and benefit costs.

STAFFING AN INDEPENDENT AGENCY

OFHEO Staffing Philosophy

My objective has always been to create a lean, flat organization with the necessary institutional capability to fulfill the mission, maintain independence and ensure accountability. I am building a diverse staff with sophisticated financial, legal and supervisory expertise. I will reward managers for efficient and creative execution of tasks, not for the number of employees they oversee. High achievers will be rewarded without having to be made managers. Individual staff will be expected to have diverse skills, exhibit flexibility and function in a variety of areas. I can tell you that I personally roll up my sleeves and perform any job that needs doing; I expect no less from my staff. OFHEO is a results-oriented agency and I intend to foster excellence throughout.

Evaluating the Merits of Hiring Government Staff vs. Consultants

This is a start-up agency. That is an important consideration in evaluating the merits of hiring governmental employees versus consulting staff. Clearly, the leadership for this agency must come from governmental employees. However, consultant staff provides flexibility, by easing work loads during peak periods, as well as performing specialized and one-time tasks. A preliminary survey of the consulting and contracting universe highlights the following issues:

1. Consultants Cost More

Consultants have quoted hourly rates up to seven times those of talented candidates being considered for permanent positions at OFHEO. On average, employees obtained through consulting firms cost two to three times as much as government employees. While we are funded by assessments on Fannie Mae and Freddie Mac, rather than the Treasury, my goal has been to

minimize costs wherever possible. Extensive use of consultants may militate against that objective.

2. Government Should Not Pay to Develop Consultants' Expertise

There is no consultant presently positioned to model Fannie Mae and Freddie Mac's capital adequacy without a lengthy start up period. Were we to engage consultants for that fundamental function, the OFHEO budget would in effect subsidize their education and training. The consultant could subsequently walk away with marketable expertise gained at public expense, potentially leaving OFHEO in a vulnerable position.

3. Confidentiality and Conflict of Interest

The use of contractors raises issues of confidentiality as well as conflict of interest. If contractors are to work with the enterprises' proprietary data, safeguards will have to be developed that will complicate and slow our work. Most researchers have or have had financial relationships with one or the other enterprise, and we will have to establish procedures to protect the integrity of the regulatory process.

4. It takes longer to hire consultants than full-time staff.

The lead time associated with the Federal procurement process may slow down our efforts significantly.

I place great value on austerity and efficiency, but I do not believe in sacrificing quality or creativity. As you know, Mr. Chairman, false economies carry an enormous price tag. OFHEO cannot risk being "captured" by the regulated entities because a lack of resources and staffing prevents us from doing our job. OFHEO's mission is to protect the public.

Mr. Chairman, and members of the subcommittee, I have touched upon issues here today that are of great importance to all of you and to the Administration. The issue of staffing and contracting is essential to the discussion of reinvention. In a few years time, I would like to see the Office of Federal Housing Enterprise Oversight held up as a model exemplifying the best of reinvention.

The issue of protecting the taxpayer is also of great significance. This office was created out of grave concern for the consequences to all of us from a potential failure of the government-sponsored enterprises. It is essential that OFHEO operate as an independent regulator. Particularly, at this early stage, it is essential that I, as Director, have the flexibility and resources necessary to fulfill the public trust.

I will continue to work tirelessly to create an office that ensures the financial safety and soundness of Fannie Mae and Freddie Mac. Mr. Chairman, members of the subcommittee, this is a very big job. A great deal is at stake. I welcome your support. I look forward to working closely with you in the near future, and now I will be happy to answer your questions.

ATTACHMENTS

Attachment A:

REGULATORY CONTEXT: MISSION, AUTHORITY, AND STRUCTURE

Attachment B:

**REGULATORY CONTEXT: ASSET BASE OF REGULATED ENTITIES,
REGULATORS' BUDGET, AND STAFFING**

Attachment C:

1 - OPM CONFIRMATION OF SCHEDULE A HIRING AUTHORITY

2 - EXPLANATION OF SCHEDULE A HIRING AUTHORITY

REGULATORY CONTEXT: MISSION, AUTHORITY AND STRUCTURE

	Federal Reserve System (FED)	Federal Deposit Insurance Corporation (FDIC)	Office of Thrift Supervision (OTS)	Office of the Comptroller of the Currency (OCC)	Office of Federal Housing Enterprise Oversight (OFHEO)
Mission	Established 1913. Independent entity. Supervises and regulates approx. 1,000 state banks which have joined the Federal Reserve System.	Established 1933. Independent agency. Insurance program for banks. Primary regulator of approx. 7,300 state-chartered, non-member commercial banks.	Established 1989. Independent bureau of Treasury. Primary regulator of approx. 1,800 savings associations.	Established 1863. Independent bureau of Treasury. Charters and regulates approx. 3,900 national banks.	Established 1992. Independent bureau of HUD. Financial regulator of FNMA and FHLMC
Executive Officer	Chairman/Vice Chairman. Presidential appointment, Senate confirmation. Four-year term. Executive Level II.	Chairperson/Vice Chairperson. Presidential appointment, Senate confirmation. Five-year term. Executive Level III.	Director.	Comptroller of the Currency.	Director. Presidential appointment, Senate confirmation. Five-year term. Executive Level II.
Authority	Issues regulations, conducts examinations, initiates enforcement actions.	Issues regulations, conducts examinations, initiates enforcement actions. Also liquidates assets of failed banks.	Issues regulations, conducts examinations, initiates enforcement actions.	Issues regulations, conducts examinations, initiates enforcement actions.	Issues regulations, conducts examinations, initiates enforcement actions.
Funding	Receives no Congressional appropriations. Funded through assessment of member banks.	Receives no Congressional appropriations for operating budget. Funded through fees and deposit insurance premiums paid by regulated institutions.	Receives no Congressional appropriations. Funded through fees and assessments paid by regulated thrifts.	Receives no Congressional appropriations. Funded through fees and assessments paid by regulated banks.	Receives no Congressional appropriations. Funded through assessment of FNMA and FHLMC
Pay Schedule	Exempt from Federal pay, classification requirements.	Exempt from Federal pay, classification requirements.	Exempt from Federal pay, classification requirements.	Exempt from Federal pay, classification requirements.	Exempt from Federal pay, classification requirements.

REGULATORY CONTEXT:
ASSET BASE OF REGULATED ENTITIES,
REGULATORS' BUDGET AND STAFFING

	Federal Housing Finance Board (FHFB)	Office of Thrift Supervision (OTS)	Office of the Comptroller of the Currency (OCC)	Office of Federal Housing Enterprise Oversight (OFHEO)
Source of Funding	Assessment of Federal Home Loan Banks	Assessment of Thrifts	Assessment of Banks	Assessment of Federal Housing Enterprises
Asset Base of Entities Regulated (in billions)	\$165	\$800	\$2,004	\$1,040
Annual Operating Expenses (in millions)*	\$15.0	\$212.1	\$316.4	\$10.6
Total FTE's	124	2,527	3,615	45
Assets Regulated Per FTE (in millions)	\$1,331	\$317	\$554	\$23,111

NOTE: The Federal Deposit Insurance Corporation and the Federal Reserve System were excluded from this comparison. Both are involved in activities above and beyond regulation, such as deposit insurance and money supply management.

* FHFB and OFHEO amounts represent proposed FY 1994 budget;
 OTS and OCC amounts represent actual expenses per 1992 annual reports.

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ATTACHMENT C - 1

OFFICE OF THE DIRECTOR

UNITED STATES
OFFICE OF PERSONNEL MANAGEMENT
WASHINGTON, D.C. 20415

JUL 22 1993

Honorable Henry G. Cisneros
Secretary of Housing and Urban
Development
Washington, DC 20410-0001

Dear Secretary Cisneros:

We are pleased to approve your request for Schedule A appointment authority to staff the newly established Office of Federal Housing Enterprise Oversight. Appointments may be made under this authority for a period of 2 years.

I have asked the Associate Director for Career Entry, Mr. Leonard R. Klein, to notify your agency's personnel office of the approval, and provide additional appointment information. His staff is also available to answer any questions that may arise.

I hope this authority will assist you with your initial staffing needs for the Office of Federal Housing Enterprise Oversight.

Sincerely,
James B. King
James B. King
Director

"SCHEDULE A" HIRING AUTHORITY**1. What is "Schedule A" hiring authority?**

Schedule A authority is one of the federal government's excepted appointing authorities used for hiring employees under special circumstances. This authority permits agencies to fill positions without following the extensive requirements of the competitive service.

2. What are the advantages of using Schedule A hiring authority?

- Schedule A authority permits hiring to proceed more expeditiously since fewer requirements must be met. Only basic requirements are prescribed by law or regulation. An agency authorized to use Schedule A hiring authority develops its own specific requirements and procedures for staffing the positions it wishes to fill.

3. Is there any precedent for using Schedule A authority in a situation similar to the creation of OFHEO?

The Federal Personnel Manual cites, among other examples, the following:

"A crash program [which] must be staffed so quickly that there is no time for traditional examining."

The financial regulatory agencies (Office of Thrift Supervision, Resolution Trust Corporation, Federal Housing Finance Board) created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) were granted Schedule A hiring authority by the Office of Personnel Management for use during their start up phase.



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